

Life Insurance and Advice Working Group

Interim Report on Retail Life Insurance Advice

John Trowbridge

17 December 2014

TABLE OF CONTENTS

FOREWORD	i
EXECUTIVE SUMMARY	iii
SUBMISSIONS	viii
1. LIFE INSURANCE AND THE ROLE OF ADVISERS	1
2. LIFE INSURANCE INDUSTRY STRUCTURE	5
3. OPTIONS FOR REFORM: QUALITY OF ADVICE	13
4. OPTIONS FOR REFORM: ADVISER REMUNERATION AND OTHER INCENTIVES	22
5. OPTIONS FOR REFORM: INSURER PRACTICES AND PRODUCT OFFERINGS	33
6. OPTIONS FOR REFORM: INDUSTRY PRODUCTIVITY	39
APPENDIX 1 – TERMS OF REFERENCE AND BIOGRAPHIES	43
APPENDIX 2 – WARNING SIGNS AND LIFE INSURANCE ADVICE CHECKLIST.....	45
BIBLIOGRAPHY.....	52

FOREWORD

LIFE INSURANCE & ADVICE WORKING GROUP

INTERIM REPORT (“TROWBRIDGE REPORT”)

BACKGROUND

ASIC released a Review of Retail Life Insurance Advice in October 2014. Its findings and recommendations are of great concern to the financial advice industry and the life insurance industry. Immediately following the critical ASIC findings, the Association of Financial Advisers (AFA) and the Financial Services Council (FSC) established a Life Insurance and Advice Working Group (LIAWG) headed by an independent chairman, former APRA member John Trowbridge, to review the ASIC report and present durable solutions to the issues raised.

INDEPENDENCE OF THE TROWBRIDGE REPORT

The financial advice and life insurance industries are determined to strengthen trust and confidence in the life insurance sector.

The AFA and the FSC have accepted at face value the primary concerns of ASIC, which relate to quality of advice and correlation of up-front commissions with poor advice.

Mr Trowbridge, the LIAWG’S independent chairman, has received extensive input from the AFA and the FSC and other stakeholders, with a view to assisting the industry to respond to the ASIC findings and, through an agreed process, to develop an “industry-wide response” sought by ASIC.

The LIAWG includes representatives from the AFA (Brad Fox, John de Zwart and Jeff Thurecht) and the FSC (John Brogden, (who has been succeeded by Sally Loane), Andrew Hagger and Geoff Summerhayes.) Both associations have been meticulous in their efforts to maintain the independence of the Chairman and his work.

Mr Trowbridge has agreed to a three step process:

1. prepare an *interim report* in the nature of an issues paper or an options paper (for public release in December 2014)
2. *invite submissions* from interested parties to the interim report (January 2015), and
3. prepare a set of *independent recommendations* in a report for public release (scheduled for March 2015).

INTERIM TROWBRIDGE REPORT

This document is Mr Trowbridge’s interim report.

Any opinions and views expressed that are not otherwise qualified are those of the Chairman and do not necessarily have the support of the AFA or the FSC or of any particular segment of the life insurance industry, AFS licensees or the advice industry.

*The **AFA** is the **Association of Financial Advisers**. It represents a significant part of the financial advice industry. Using the mantra “great advice for more Australians” and counting more than 2,500 individual members and a reach of around 9,000 advisers through partnerships with AFS licensees, it has a membership covering the breadth of advisers from employees of dealer groups owned by life insurers, banks or other financial institutions, as well as advisers employed with small business advice practices and self-licensed advisers. Its input to the LIAWG has come from its Board of Directors (each are practising financial advisers), an adviser member Life Insurance Working Group, and a Licensee Life Insurance Working Group.*

*The **FSC** is the **Financial Services Council**. It represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The FSC has over 125 members who are responsible for investing more than \$2.3 trillion on behalf of 11 million Australians. This includes almost all of the life insurers authorised to operate in Australia and many AFS licensees. The FSC's input to the LIAWG has come through its Life Board Committee, representing life insurers, and the Advice Board Committee, representing AFS licensees. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.*

Mr Brad Fox
Chief Executive Officer
Association of Financial Advisers

Ms Sally Loane
Chief Executive Officer
Financial Services Council

Sydney

17 December 2014

EXECUTIVE SUMMARY

Background to the Life Insurance and Advice Working Group

Quality advice and improved insurance coverage across the community are essential to the wellbeing of all Australians. This is recognised by the financial advice and life insurance industries who are determined to rebuild trust and confidence in the life insurance sector.

ASIC's *Review of retail life insurance advice* (October 2014) urged the development of industry-wide solutions for the misaligned incentives that ASIC found were influencing the quality of life insurance advice.

In immediate response, the Association of Financial Advisers and the Financial Services Council established the Life Insurance and Advice Working Group (LIAWG) in October 2014, with myself as its independent Chairperson with the following objectives:

"The LIAWG will review ASIC's report and make recommendations on how the industry can respond to the issues identified to ensure that Australians are adequately insured and receive world class financial advice."

The full Terms of Reference are reproduced in Appendix 1.

A final report will be prepared by the end of March 2015.

The purpose of the Interim Report

Because significant change might be involved, the AFA and the FSC understand that an effective response to the ASIC Review may herald some level of transformation of the life insurance and advice industries. Hence their willingness to undergo an open and independent process in search of reform solutions.

This Interim Report is in the nature of an issues and options paper on which feedback is sought via submissions. The Interim Report is independent and does not provide any preliminary or draft recommendations. These will be included in the final report.

Approach of the Life Insurance and Advice Working Group

In preparing the report, I have consulted with a wide range of industry participants (insurers, advisers and licensees), consumer representatives and regulators. Their input, along with extensive assistance and debate from LIAWG members and a small Secretariat led by Spiro Premetis from the Financial Services Council have been invaluable in enabling the preparation of the Interim Report.

In considering the matters raised by ASIC, I have examined in this report four subject areas. They are

-

1. quality of advice
2. remuneration and other adviser incentives
3. insurer practices and product offerings
4. industry productivity.

The report raises numerous issues and questions across each of these subject areas.

In attending to these issues and questions, the report explores why life insurance is important to the community and why good quality advice is needed. It also considers how remuneration for insurance

advice needs to be different from investment advice and why it is important to retain some form of commissions rather than ban them, as has occurred with investment products. It also explains how existing remuneration arrangements, with their high upfront commissions, can be seen as creating a conflict of interest for advisers and how insurers, licensees and advisers could better manage this conflict.

1. Quality of advice

Quality of advice is examined in four parts: advice standards, adviser education and culture, regulatory obligations and constraints on advisers, and competitive constraints on advisers.

Advice standards and adviser education & culture

ASIC has drawn attention to the distinction between “strategic life insurance advice” and life insurance product advice, noting the importance of the former but its absence in many cases.

The ASIC Review’s extensive list of suggestions on standards of advice includes a “Life insurance advice checklist”.

Key questions arising include:

Should ASIC’s suggestions on advice quality, including its Life insurance advice checklist, be adapted and developed as a professional standards manual to which all licensees and advisers would conform?

How might such a manual be used effectively in the training and professional development of financial advisers and licensees?

What other training and educational initiatives are needed for licensees and advisers to maintain the competency of existing advisers and develop the competency of new advisers?

How might the culture in insurance advice best be enhanced to encourage peer review, referral to a more experienced adviser or even declining to advise a client?

Regulatory obligations and constraints on advisers

Statements of advice (SoAs) are a major aspect of both the obligations on advisers and, in view of all the regulatory constraints on advisers, how they affect the quality of advice.

Inherent in the receipt of good client advice is clear, succinct and accurate transmission of information and advice from adviser to client. The requirements around SoAs and the current practices in preparing and delivering them can be an impediment to effective communication with clients.

The key question arising is:

How could SoAs be better structured, including being shorter (from over 20 pages to less than 10 pages), both to improve their effectiveness as a tool of communication and to reduce the burden of their preparation on advisers?

Competitive constraints on advisers

A prominent factor in constraints on advisers relates to Approved Product Lists (APLs). Each AFS licensee makes its own determinations as to which platforms, investment products and life insurance products are on its Approved Product List. Its financial advisers are then largely limited to offering only those products that are on the list.

The main questions arising are:

Are APLs restricted in ways that limit competition and/or limit adviser awareness of market offerings and market developments, to the detriment of clients?

Is there a case for open architecture for APLs so that advisers are not unduly restricted and clients can have confidence that their advisers are genuinely meeting their best interest obligations?

2. Adviser remuneration and other incentives

ASIC has recommended that insurers “address misaligned incentives” and “review their remuneration arrangements to ensure that they support good quality outcomes for consumers and better manage the conflicts of interest within those arrangements.” It also recommends that AFS licensees “ensure that remuneration structures support good quality advice that prioritises the needs of the client” and that they “review their business models to provide incentives for strategic life insurance advice”.

Addressing these issues in a way that provides a meaningful change to industry culture and practices, and prevents or mitigates poor quality outcomes for consumers, both direct remuneration (commission) arrangements and other adviser incentives need to be considered.

Adviser remuneration

ASIC has expressly stated its concerns about high upfront commissions and the recently released Financial Services Inquiry report echoes those concerns and goes on to recommend a level commission structure.

There is, however, widespread acknowledgement that there are material costs in the process of taking a client from the initial advice stage through to taking out a life policy. The FSI report noted that high upfront commissions are “a long-standing industry practice reflecting that life insurance has higher arranging costs, such as managing the underwriting process, and that consumers are often not independently motivated to purchase life insurance.”

For these reasons, the concept of upfront commissions is not dismissed but instead included within a range of commission-related options on which this report is seeking submissions. At the same time, the report does dismiss the idea of continuing with the most common current practice of upfront commissions, which typically are 100% to 130% of the first year’s premium. Equally, the report dismisses the idea of a nil commission model.

Five models for direct adviser remuneration are put forward as worthy of consideration and debate in the search for a sustainable “reform model”:

- **Level commissions only** (no extra commission in Year 1) and no other direct remuneration. We can assume that under this model the rate would not be greater than 30% and would not be lower than 20%.
- **Hybrid commissions** as currently understood as the maximum commissions (for example, dictating a maximum upfront commission of 80% and level commission thereafter).
- **Modified hybrid** comprising initial remuneration of a combination of commission at a level less than the current hybrid plus a fixed dollar payment. Renewal commissions could be as per current hybrid arrangements.
- **Level plus fees** comprising level commissions, at a rate to be considered, supplemented by an initial payment in the nature of a fee from the insurer to the adviser. Such a payment would not be a commission but a fee in the nature of cost recovery or expense reimbursement.
- **Level funded** as a variation on 'level' where the commissions are level but to offset initial costs, on each policy inception the insurer lends the adviser funds that are repayable over say 3 to 5 years from renewal commissions.

In assessing options for adviser remuneration, consideration should be given to the short run and long run sustainability of advised life insurance at all levels: insurer, licensee, adviser and client. A solution which makes it too difficult for one or more of these parties to participate in the provision of life insurance will ultimately disadvantage all parties.

It should be noted that at this stage these models are not fully specified and that ultimately any preferred or chosen reform model will not stand alone. It will necessarily be part of a more comprehensive package of proposals that would also encompass matters of advice quality, adviser-licensee arrangements, insurer practices, insurer product offerings and industry productivity measures.

Numerous questions need to be explored for each of these models:

- Design –

How exactly might each model be specified and how would it work?

What kind of transitional pathway would be needed to move from the current situation to the preferred reform model?

- Potential benefits, costs, risks, desirability and disadvantages –

What are the consequences, the main pros and cons and the main trade-offs for each of consumers, advisers, licensees, and insurers?

To what extent would the model minimise adviser conflicts of interest and encourage strategic life insurance advice, while also maintaining and promoting insurance coverage across the community?

How sustainable is it likely to be and what conditions would need to apply within the insurance life insurance industry and the advice industry to ensure its sustainability?

- Implementation mechanism –

Could the preferred model be introduced and operate effectively on a self-regulatory basis, with ACCC authorisation and without the need for government legislation or regulation?

Insurer practices and product offerings

A Life Insurance Industry Code of Practice or Charter

Consumer groups have expressed an interest in a code of practice for life insurers. The insurers along with licensees and advisers have indicated some interest in such a code. It is noteworthy that both the general insurance industry and the banking industry have had formal Codes of Practice operating for some years, primarily to respond to consumer and regulatory pressures on the industry.

Key issues for consideration include:

Should the life insurance industry establish its own Code of Practice for the benefit and protection of consumers and to assist advisers and licensees?

What would be the scope of such a code and how would compliance be managed?

Other topics identified in the report around insurer practices and product offerings relate to –

- Stepped and level premiums
- Replacement policies
- Insurer flexibility and apparent bureaucracy
- Rating agencies.

The report identifies several questions on each of these topics. They cover a range of issues of product design, insurer practices, regulatory requirements and consumer protection. Further investigation may show that some aspects could be covered in an insurer code of practice while others, if worthwhile pursuing, may need other solutions.

Industry productivity

This interim report has identified a number of possible initiatives that have potential to improve adviser productivity and insurer efficiency or competitiveness. Several such possible initiatives are covered in various parts of the report within other topics. The last chapter of the report has identified another nine possible productivity initiatives that could be introduced by insurers, in some cases acting individually and in other cases acting on an industry basis.

The primary question arising in respect of each such possibility is:

How feasible would the idea be for insurers to introduce, how effective would it be and how willing would insurers be to take it on?

The full interim report that follows expands on all of the above.

SUBMISSIONS

The Life Insurance and Advice Working Group (LIAWG) is inviting submissions on the questions set out in this interim report. Submissions will be taken into account in the preparation of the final report scheduled for March 2015

The deadline for submissions is 30 January 2015.

Submissions on all of the questions in the interim report are welcome but respondents should not feel they must address each question in the interim report in making a submission. Submissions should highlight particular issues, ideas, data or research that may be relevant to the final report that I will be preparing with recommendations aimed at ensuring quality advice for consumers and improved insurance coverage across the community. These aims will guide assessment of the submissions.

The working group is keen for submissions from all segments of the life insurance and advice value chain, namely insurers, licensees, advisers, consumers and government agencies. Submissions can be from individuals, businesses or representatives of any of these groups.

Submissions will not be published and will be treated as confidential. Those lodging submissions are free to make their own arrangements to make their submissions public should they choose to do so.

Submissions will be made available on a confidential basis to members of the LIAWG and its Secretariat.

Submissions should be provided by email to:

submissions@trowbridge.com.au

For further information, please contact the Secretary of the Life Insurance and Advice Working Group, Mr Spiro Premetis, Policy Manager – Life Insurance at the Financial Services Council (spremetis@fsc.org.au).

John Trowbridge

Independent Chairman
Life Insurance and Advice Working Group

1. LIFE INSURANCE AND THE ROLE OF ADVISERS

On 9 October 2014 the Australian Securities and Investments Commission (ASIC) released its report, *'Review of retail life insurance advice'*.¹ Conducted between September 2013 and July 2014, ASIC's review was limited to the retail distribution channel for life insurance and looked at:

- *"how life insurance is sold by advisers;*
- *"how advisers are remunerated for that advice;*
- *"the drivers behind product replacement advice to consumers; and*
- *"the quality of the personal advice consumers receive."* – Para. 5

1.1 KEY AREAS OF INTEREST FROM ASIC'S REVIEW

ASIC's review of 202 advice files found overall that the quality of personal advice was below standard and that there was a high correlation between low quality advice and upfront commission arrangements. The Review noted that 37 per cent of consumers received life insurance advice that failed to comply with the law. ASIC also made a number of recommendations outlined in Box 1 below.

Box 1: ASIC's recommendations

Paragraph 25:

We recommend that insurers:

- (a) address misaligned incentives in their distribution channels;*
- (b) address lapse rates on an industry-wide and insurer-by-insurer basis (e.g. by considering measures to encourage product retention); and*
- (c) review their remuneration arrangements to ensure that they support good-quality outcomes for consumers and better manage the conflicts of interest within those arrangements.*

Paragraph 26:

We recommend that AFS licensees:

- (a) ensure that remuneration structures support good-quality advice that prioritises the needs of the client;*
- (b) review their business models to provide incentives for strategic life insurance advice;*

Note: Strategic life insurance advice includes advice on the type, level, structure and affordability of life insurance cover based on the client's cash flow position and which prioritises the client's insurance needs. Strategic advice can be stand alone or, where appropriate, provide the framework for product advice.

- (c) review the training and competency of advisers giving life insurance advice; and*
- (d) increase their monitoring and supervision of advisers with a view to building 'warning signs' into file reviews and create incentives to reward quality, compliant advice.*

¹ ASIC Report 413 'Review of retail life insurance advice', 9 October 2014.

It is these findings and recommendations that were central to the decision by the AFA and the FSC to commission this report. Their goal is to gain an understanding of what lies behind these matters and to develop a program of initiatives designed to overcome the problems identified by ASIC.

1.1.1 STANDARDS OF ADVICE

ASIC identified a range of advice areas where the advice provided did not meet the standard required by the law. In ASIC's view:

"We have found significant room for improvement among the advice we reviewed and we will be actively working with the advice industry to lift the standard of life insurance advice."
– Para. 18

The specific areas identified where advice could be improved included:

- **Inappropriate scaling of advice:** where the adviser failed to exercise sufficient prudence and judgement in the scope of their inquiries into the client's relevant circumstances.
- **Lack of strategic life insurance advice:** where the adviser failed to add any meaningful value to their clients by: (a) helping them set an appropriate sum insured, balancing the competing priorities of underinsurance versus affordability; (b) testing the value of optional extras against the client's ability to sustain the insurance over time by prioritising the essential and the non-essential; or (c) helping the client evaluate the merits of stepped versus level premiums relative to the amount of time the client may expect to hold insurance.
- **Weak rationales for product replacement advice:** where the advice lacked strategic consideration of the issues that brought the client to the adviser in the first instance.
- **Failure to consider the relationship between life insurance and superannuation:** where the advice failed to adequately consider the effect on retirement savings where insurance is funded through superannuation..

1.1.2 ADVISER INCENTIVES

Statements made by ASIC in its report suggest that remuneration arrangements create an incentive to offer advice that may not be in the best interest of the client (notwithstanding the legal requirements of the best interests duty). In ASIC's view:

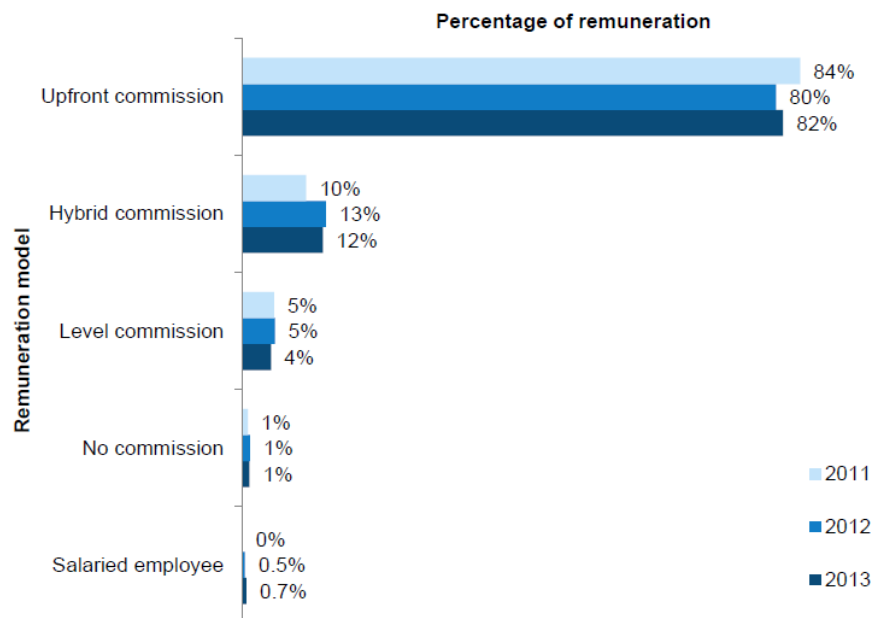
"A remuneration arrangement tied to a product sale creates an incentive for the adviser to make a sale, rather than provide non-product-specific advice or strategic advice for which the adviser may not be paid." – Para. 161

To support this conclusion, ASIC noted that 80 per cent of advice files in their sample used an upfront commission model. This was roughly aligned with data provided by insurers which showed policies with full upfront commissions represent 82 per cent of insurers' business (see Figure 1). Further, 96 per cent of advice that was rated a fail used an upfront commission model.

ASIC also noted that insurance policies where the adviser was remunerated with upfront commission had significantly higher lapse rates relative to hybrid or level commission policies (see

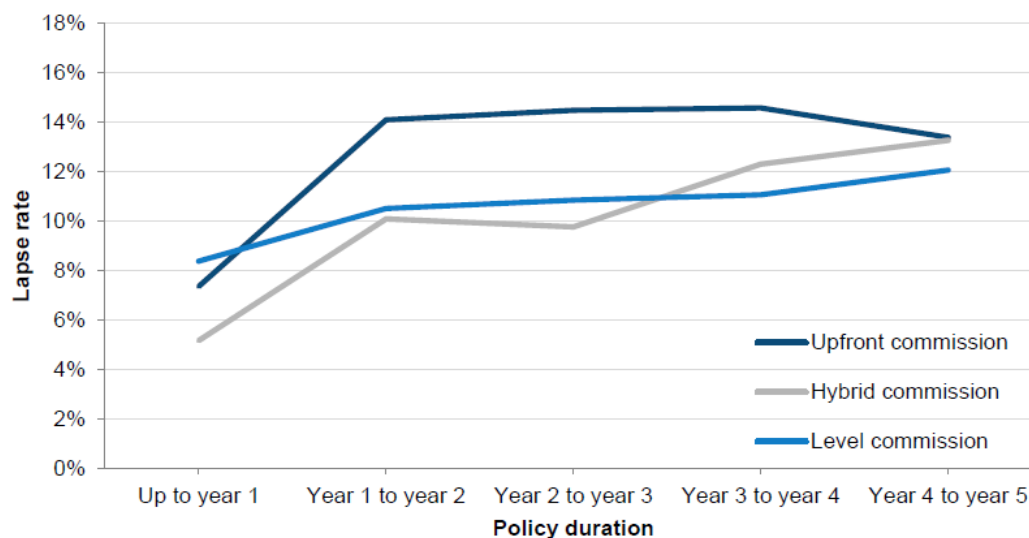
Figure 2). Specifically, for stepped premium policies² (which represent the majority of volume), upfront commission models had a lapse rate of around 7 per cent in the first year of the policy, which doubled to 14 per cent in the second year. This is higher than that recorded on policies where the adviser was remunerated with Hybrid or Level Commission.

Figure 1: Remuneration models – Averages (2011 to 2013)



Source: ASIC (2014)

² A stepped premium policy is a policy which is priced one year at a time by the insurer and accordingly is re-priced upwards annually with each year of advancing age of the insured.

Figure 2: Lapse rates by remuneration arrangement for stepped premium policies

Source: ASIC (2014)

ASIC's overall view is that current practices appear to be entrenched and an industry wide solution is required to improve adviser incentives and their impact on the quality of advice, specifically noting that:

"High upfront commissions give advisers an incentive to write new business. The more premium they write, the more they earn. There is no incentive to provide advice that does not result in a product sale or to provide advice to a client that they retain an existing policy unless the advice is to purchase additional covers or increase the sum insured." –Para.147

And that,

"...an individual insurer may change its remuneration arrangements to mitigate the effect of conflicts of interest amongst advisers selling their policies, but is likely to lose business to competitors." –Para.21

1.2 ROADMAP TO THE INTERIM REPORT

The next chapter (Chapter 2) gives adviser industry and life insurance industry relevant background with the remainder of the report covering various options for reform across four dimensions, namely Specifically, quality of advice (Chapter 3), adviser remuneration and other incentives (Chapter 4), insurer practices and product offerings (Chapter 5) and industry productivity (Chapter 6).

The Interim Report details the key issues and options being considered by the Life Insurance and Advice Working Group. The Interim Report is independent and does not provide preliminary or draft recommendations. These will be included in the Final Report.

2. LIFE INSURANCE INDUSTRY STRUCTURE

Official statistics published by APRA note that as at 30 June 2013 there were 28 life insurance companies in Australia, with seven large to very large life insurers selling a diversified range of products (four of these are members of the major banking groups), a smaller number of mid-sized risk or investment specialists, a handful of small life insurers servicing specialist or captive markets and seven reinsurers.³

Distribution of life insurance in Australia can generally be classified into three market segments: the group, retail and direct markets. One key difference between these three market segments is the degree to which advice is received by the customer before purchasing a product. This difference also translates into a difference in distribution practice. **Group insurance** is commonly delivered through superannuation funds as part of the fund's suite of member benefits and may be subject to advice by a Corporate Superannuation adviser. This type of insurance would typically be offered to members on a general advice basis. **Retail life insurance products** are typically recommended by financial advisers who offer personal advice to clients. Customers access **direct life insurance products** through a general advice distribution model, typically delivered through call centres or on line websites. Table 1 summarises some of the differences between distribution channels.

Table 1: Difference across Group, Retail and Direct life insurance distribution channels

Market Segment	Group	Retail	Direct
Degree of consumer engagement	Low – none. Cover is provided as default. Not –typically underwritten – under Automatic Acceptance Limits.	High. Cover is sold after advice is provided. Underwritten.	Medium. Cover is bought after consumer call or internet application in response to advertising.
Policy Ownership	Trustee	Individual	Individual
Capital intensity (relative)	Low	High – distribution and underwriting costs	High – advertising and operating costs
Appropriateness of cover for consumer	Low – Medium depending on the degree to which the consumer is engaged with their superannuation	High based on quality of financial advice being provided	Low – Medium depending on the depth of knowledge of the consumer in understanding own needs and comparing policies

There are other significant differences in business models, acquisition costs and profitability between the group, retail and direct markets. The retail market, which is the focus of this report, is the most complex with the involvement of advisers and licensees operating across the ordinary non-superannuation and superannuation sectors.

There were an estimated 2.6 million policies in force at 30 June 2013, representing some \$12.8 billion of in-force premiums.

³ APRA (2013) *Insight Issue Three 2013*, 'General Insurance industry overview' <http://www.apra.gov.au/Insight/Pages/Insight-Issue-Three-2013-HTML.aspx>

2.1 BACKGROUND

To understand the general environment for life risk insurance products, with particular reference to the role of financial advisers and commission payments related to product sale and advice, two features of the life insurance industry in Australia are worth highlighting. They are the demand for life risk insurance products, and the market penetration of life risk products.

2.2.1 THE DEMAND FOR LIFE RISK INSURANCE PRODUCTS

The commonly stated view that life insurance products are ‘sold not bought’ highlights the historical observation that the market penetration of life insurance in Australia and elsewhere is dependent on the use of intermediaries to promote take up of adequate insurance cover.

Compared to other financial service products such as home and motor insurance, mortgages and investment products, which are essentially demand driven, the need for a life insurance product is often not obvious to customers without an intermediary being present to explain and promote its value and its benefits.

Life insurance is also not standardised and often multi-faceted. The risks tend not to materialise at a single point in time so there is no immediate “call to act”. The purchase decision tends to be treated as deferrable and often is deferred owing to behavioural biases.

2.2.2 THE BENEFITS OF LIFE INSURANCE AND ITS MARKET PENETRATION

Life insurance helps protect Australians against the social and economic impacts of premature death, as well as long term or short term illness, injury or disability that impacts their ability to earn an income. This is arguably the most important financial protection a person can obtain. Yet statistics show that many Australians have either no insurance or insufficient insurance to protect their financial position.

2.2.3 THE CONSUMER BENEFITS OF QUALITY FINANCIAL ADVICE

Financial advisers make a major contribution to consumers obtaining advice on insurance that meets their needs. Insurance products can be complicated and may not necessarily be easy to understand in terms of what cover is and isn’t provided, what exclusions may apply to a client’s situation and to determine what the right level of cover is.

ASIC’s Report notes the substantial value of personal advice by advisers⁴:

“Advisers are in the business of giving personal advice in most situations. The value of personal advice is that it:

- (a) is tailored to the client and their relevant personal circumstances;*
- (b) considers the client’s insurance needs and balances those needs against their other priorities;*

⁴ Para 254 to 259 ASIC Report 413 (2014) ‘Review of retail life insurance advice’ detail the value that quality financial advice can provide to a consumer.

- (c) *does not rely on generic calculations to reach a sum insured or fail to make inquiries of the client to test or challenge their assumptions; and*
- (d) *leaves the client in a better position.”* (para 253)

2.2.4 LIFE INSURANCE COMMISSIONS IN AUSTRALIA TODAY

Life insurance commissions have always been a feature of the industry throughout the world and Australia is no different. The impact of this practice, however, has been considered in recent years because of the Government’s interest in financial advice generally.

FoFA represents the former Government’s response to the recommendations of the “Ripoll Inquiry”, a Parliamentary Joint Committee on Corporations and Financial Services (PJC) inquiry into financial products and services in Australia. The Ripoll Inquiry was set up in 2009 to inquire into, and report on, issues associated with financial products and service provider collapses that occurred in the wake of the Global Financial Crisis (GFC).

While the Ripoll Inquiry recommended a ban on remuneration payments that influence the advice provided to the client, it specifically considered whether life insurance products should be exempted from any ban on remuneration (and other additional regulatory obligations). This consideration indicated an implicit view from the Ripoll inquiry that underinsurance was a significant issue and that the positive benefits life insurance provides individuals and to the broader community merited consideration of ways in which to promote consumers to take up this product. Further, it reflected concerns that removing direct remuneration payments to advisers would substantially increase up-front costs of acquiring insurance. It could potentially result in considerably less insurance being sold through advisers, consequently leading to a significant reduction in the number of people receiving advice on their insurance needs. The recommendations included in the report had bi-partisan support.⁵

In the final implementation of the FoFA reforms the Government decided that the ban on conflicted remuneration should not apply to retail risk insurance advice, referring to the rationale and consistency with the recommendations of the Cooper Review into Australia’s Superannuation System, which noted:

“There is widespread agreement that Australians generally are under-insured. It has been commented that insurance is generally sold, rather than bought, and that widespread under-insurance means that measures to restrict incentives for the sale of life insurance should therefore be considered with caution. In the Future of Financial Advice reforms, the Government indicated that it would consult further about whether to extend the ban on commissions to risk insurance (including group risk insurance). This was because insurance has different features from investment products, including the fact that, unlike superannuation, there are no investment funds which might be used to pay for advice.

⁵ Mike Taylor, ‘Bipartisan support for Ripoll recommendations’ *Money Management*, 23 November
<http://www.moneymanagement.com.au/news/financial-services/archive/bipartisan-support-for-ripoll-recommendations>

Therefore, concerns about affordability and the potential for under-insurance needed to be explored in this context.”⁶

This was supported by both sides of government.⁷

2.2.5 THE CHANGING CULTURE OF FINANCIAL ADVICE

Before the release of this report, the Financial System Inquiry aptly noted that:

“Without a culture supporting ...the fair treatment of consumers, financial firms will continue to fall short of community expectations. This may lead to ongoing political pressure for additional financial system regulation and the undermining of confidence and trust in the financial system.”

And that:

“The Inquiry considers that industry should raise awareness of the consequences of its culture and professional standards, recognising that responsibility for culture in the financial system ultimately rests with individual firms and the industry as a whole. Culture is a set of beliefs and values that should not be prescribed in legislation. To expect regulators to create the ‘right’ culture within firms by using prescriptive rules is likely to lead to over-regulation, unnecessary compliance cost and a lessening of competition. The responsibility for setting organisational culture rightly rests with its leadership.”

There is an historical “sales culture” in the life insurance industry that has been engendered or encouraged by insurers and licensees, for their own commercial benefit, and also by advisers themselves in order to meet their own commercial needs.

A number of recent initiatives are slowly addressing the culture but it will take time to see all the benefits emerge.

The FoFA reforms have introduced a significant range of new measures which have removed conflicted remuneration and commissions on investments and superannuation as well as having introduced a statutory best interest duty for the adviser to act in the client’s best interests.

⁶ However Cooper went on to recommend a ban on up-front and trailing commission and similar payments in respect of any insurance offered to any superannuation entity, noting that: “The Panel considers that questions of affordability in the context of group life and TPD insurance are of less relevance than may be the case with individually acquired insurance, in that the trustee arranges the insurance, and the member’s superannuation balance is available to pay premiums. At the same time, the Panel notes that in the 12 months to December 2009, commissions paid by life insurers for the acquisition and maintenance of policies amounted to \$2.09B, compared with \$3.8B in meeting death and disability claims. While these figures relate to products both within and outside the superannuation system, it is clear that commissions represent a major expense for life insurers, and by implication for superannuation fund members. A number of submissions supported banning commissions. The Panel agrees with these views. Additionally, it believes that insurance commissions should be prohibited in respect of all superannuation products regardless of whether the insurance cover is a default cover or not. The Panel is also concerned that allowing commission-based payments for insurance would mean that financial planners could still be conflicted in giving their superannuation advice.”

⁷Parliamentary Joint Committee on Corporations and Financial Services ‘Dissenting Report by Coalition members of the Committee’ http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2010-13/future_fin_advice/report/d01

Advisers are also required to place the client's interests ahead of their own in a situation of conflict, making it unambiguously clear what is required of advisers.

In addition to further conduct obligations, increasing adviser education and competency standards are currently the subject of further government review and inquiry, with broad industry support for increasing the minimum competency requirements of financial advisers. Many larger licensees have also recently announced that they are increasing the education requirements for new advisers joining their business as well as existing advisers.

2.2 THE RETAIL LIFE INSURANCE VALUE CHAIN

The retail life insurance value chain is described in Figure 2. We explain the role of each aspect of this value chain below.

Figure 2: Retail life insurance value chain



Source: Adapted from Treasury (2014)

2.2.1 THE ROLES OF THE PARTIES IN THE RETAIL VALUE CHAIN

LIFE INSURERS

Life insurers are responsible for creating and managing life insurance products. They offer their products either directly to consumers (e.g. through website applications) or through distribution relationships with advice licensees or platforms (where they can be offered as stand-alone products for inclusion directly on to an approved product list or as insurance products available through platforms).

For stand-alone insurance products, a life insurer will typically enter into an agreement for the relevant advice licensee to place its life insurance products on its approved product list (APL) which then enables an adviser as a representative of that licensee, to recommend the product to the adviser's clients.

LICENSEES

A licensee is the holder of Australian Financial Services Licence (AFSL) and has an employer or contractual relationship with advisers who are authorised to provide financial advice under that licensee's AFSL. Licensees are a key conduit through which advice is made available and products are distributed to consumers in the retail market.

Licensees will typically compare and assess life insurance products and select a range of products for inclusion in an Approved Product List (APL) for their advisers to offer to their clients.

In addition to developing APLs, licensees offer a range of other services, such as practice development, compliance services, technical and research support, technology and systems, back-office support and administrative functions. Licensees also have other responsibilities with regard to the advice provided by their representatives.

There are a variety of adviser arrangements within Licensees. Some licensees employ advisers directly. This is most clearly seen in the bank branch distribution channels where employed financial advisers can be co-located in bank branches or call centres. Another form of arrangement is where a licensee approves an individual or a privately held company (a Corporate Authorised Representative), a partnership or trust to provide financial advice as a representative of the licensee. These entities represent self-employed arrangements – that is, they are in business for themselves but have the authority to provide advice under the licence of the licensee.

The vertically integrated structure of a number of life insurers has seen the growth of advisers authorised by licensees who are aligned with a financial institution as well as a consolidation among non-aligned licensees. Licensees may vary in size from an individual adviser to 1,000 or so advisers within some institutionally aligned licensees.

In the lead up to the FoFA reforms, and since their recent implementation, the advice market has experienced a significant degree of consolidation⁸. This has included insurer and other financial institutions acquiring licensees as well as licensees acquiring other licensees.

APPROVED PRODUCT LISTS & RESEARCH / RATINGS HOUSES

As stated above, a licensee will typically compare and assess life insurance products and select a range of products to include on an approved product list (APL) for their advisers to offer to their clients. At one level, APLs serve as a risk management tool for licensees and advisers whereby products have been assessed for suitability and supported in many cases by external research, prior to being included on the list. APLs are often needed for professional indemnity insurance requirements (advice which recommends products which are not on the approved product list are in many cases excluded from cover under the licensees' professional indemnity policy).

Different licensees will have different approaches to how widely they construct their APLs. Some licensees will elect to have a broad range of products and issuers available on their APLs. Others will choose to have a more restricted APL. In these cases non-approved products may be made available to advisers in their network who wish to or need to use non-APL products to meet their customer's needs, through a non approved product approval process.

However a licensee chooses to construct its APL, it will need to ensure that it meets its obligations to manage conflicts of interest and ensure that it and the financial advisers operating under its AFSL are at all times in a position to discharge their best interest duty to clients.

Box 2: Approved Product Lists and Research Houses

In order to comply with licence obligations, licensees are required to have appropriate compliance and risk management systems in place. This process generally includes having an insurance product approval process prior to any product being added to the APL. The product approval process may include (amongst other things) comparison of product features and pricing relative to market standard, ensuring the product provider has a track record and perhaps has a certain level of scale,

⁸ Milana Pokrajac, 'The new face of financial planning dealer groups', *Money Management*, 26 July 2012
<http://www.moneymanagement.com.au/analysis/top-100-dealer-groups/the-top-100-financial-planning-dealer-groups-2012>

has external research which meets internal ratings requirements (external research may be required from one or possibly two external research providers), and assessments of experience with underwriting and claims or other administration processes that will likely impact on end customer or adviser product experience.

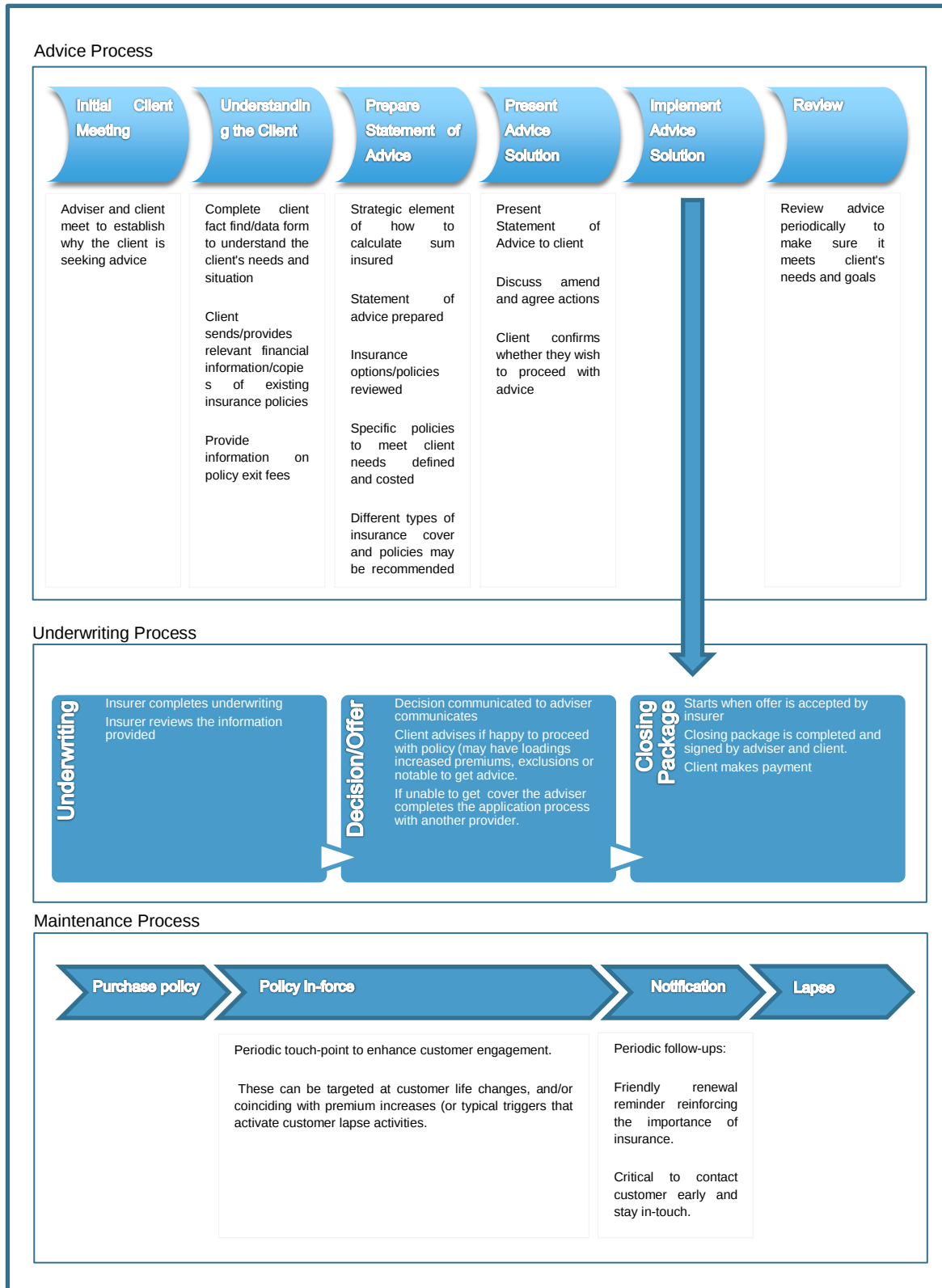
Product rating or research houses provide external reviews of products based on the features of the products. Licensees and advisers commonly utilise the analysis carried out by these rating houses as part of their due diligence in reviewing the suitability of a product for inclusion on an APL or an adviser reviewing the suitability of the product for their clients' insurance needs and making recommendations. Access to product rating research is usually on a licensed basis between the rating house and licensee.

Rating houses offer a means with which to cut through the mass of information on all available products and to support a given product's recommendation. A variety of rating methodologies exists across rating houses and as unregulated entities there is no standard or benchmark with which they have to comply. Scores provided by rating houses are often not related to how the product measures up to minimum definitions. Wider definitions on wider coverage will often improve a product's rating even when the added benefits are of little or no value to the majority of consumers.

ADVISERS

Advisers provide insurance advice, recommending the appropriate scale and type of insurance for a customer and then a specific product to cover the customer.

We set out below a depiction of the advice process for retail life insurance in Figure 3.

Figure 3: Advice process for retail life insurance

3. OPTIONS FOR REFORM: QUALITY OF ADVICE

For the advice segment, the key issues appear to be –

1. advice standards
2. adviser education and culture
3. regulatory obligations and constraints on advisers
4. competitive constraints on advisers

3.1 ADVICE STANDARDS

The ASIC Review is expansive on the subject of advice standards in life insurance. Firstly ASIC has drawn attention to the distinction between *strategic life insurance advice* and life insurance *product advice*, noting the importance of the former yet its absence in many cases.

By strategic life insurance advice ASIC means advice that “includes advice on the type, level, structure and affordability of life insurance cover based on the client’s cash flow position and which prioritises the client’s insurance needs. Strategic advice can be stand alone or, where appropriate, provide the framework for product advice.” – Para. 26b

Secondly and in more detail the ASIC Review explores –

- “Warning signs of poor advice”, which are set out on pages 63 and 64 of the ASIC Review and explained under eight different headings.
- “The challenge for insurers and advisers” that is described on pages 64 and 65 of the ASIC Review and
- A “life insurance advice checklist” that comprises the appendix to the Review, on pages 68 to 71. It contains a “list of factors to be considered when giving life insurance advice”. ASIC recommends that the list be read in conjunction with ASIC’s guidance note RG175, which relates to conduct and disclosure generally for persons who provide financial product advice to retail clients.

This material, which is reproduced at Appendix 2 to this report, could be said to comprise a reasonably comprehensive statement of good practice or best practice in the preparation and delivery of strategic life insurance advice. It covers, for example, such topics as –

- Under *warning signs*: –
 - Poor or inadequate needs analysis
 - High volumes of replacement product advice
- Under *challenges for advisers*
 - Business models that better enable advisers to provide compliant life insurance advice.
 - Effective management of conflicts of interest in all dealings with clients.
 - Assisting clients with strategic advice that balances needs and affordability.
 - When claims are made, giving clients’ effective assistance in dealing with the insurer.
- Within the *life insurance advice checklist* -

Examine the client's objectives, financial situation and all relevant aspects of the client's circumstances.
 Provide balanced "scaled advice" when the client requires advice of limited scope.
 Consider the appropriateness of retaining or replacing an existing insurance policy.

This list is but a sample of the full range of matters covered in these sections of the ASIC Review.

Often clients seeking advice in relation to life insurance are considering this aspect of their life for the first time or with very little background knowledge. An important role of the adviser is therefore to provide some level of education and insight into the options available to the client. In these discussions clients may realise the need to reframe their original objectives and as such it is important that the adviser appropriately addresses the relevant needs of the client. Further, the adviser's records and the Statement of Advice need to encapsulate the reasons for the client changing from the original objectives.

Questions

If the advice industry is to act on the ASIC recommendations, we can ask several questions with respect to licensees and advisers –

Regarding ASIC's Life Insurance and Advice Checklist

- How practical is it for solving the issues raised?
- Are any aspects of it unduly onerous?
- Are there additional considerations that it should include?

How might the Life Insurance and Advice Checklist and associated observations be utilised:

- Should it be adopted and converted into some form of professional standards manual for risk advisers and licensees?
- Should it then be incorporated into industry training material?
- If so, should the training material be a pre-requisite within the minimum training to qualify as an adviser, or should it be incorporated into designations already offered to financial advisers, or the subject of specialist training? Should it be further developed for the use of licensees with regard to compliance to guide the standards required of their advisers?

There are further questions that could also be asked of life insurers, licensees and advisers, including –

- Do all advisers currently giving personal advice on life insurance have the expertise to provide quality strategic life insurance advice and have access to the tools and support to consistently and efficiently provide it?
- For new advisers, what oversight, support and training would enable them to provide advice at the quality expected?

3.2 ADVISER EDUCATION AND CULTURE

The subject of adviser education, along with the subject of registers of advisers that record their experience and qualifications, has been widely discussed and debated elsewhere and is likely to be the subject of further regulatory action in the near future irrespective of this report. Alongside the issue of adviser education is the culture that permeates the field of life insurance advice and that can be a significant driver of adviser behaviour, both good and bad.

It is appropriate to acknowledge that in the last 40 years, the availability of strategic life insurance training has diminished considerably since the move away from tied agents. As far back as the 1970's the AFA (then known as the Life Underwriters Association) also offered specific life insurance training. In more recent times the life insurers themselves have introduced road shows designed to showcase their products. In some cases this has included training relevant to providing impartial strategic advice. There has been an increasing focus on technical aspects of advice at the expense of training around soft skills essential for effective discovery of client's goals and the likelihood they will adopt the advice provided to them to achieve those goals.

As the compliance burden on financial advisers has increased through legislation and regulation, the requirements to meet the standards expected by ASIC in providing quality strategic advice have also increased considerably. It may also be that consumer expectations have increased. The degree to which an individual adviser has received appropriate training and support is, however, difficult to measure. It has been and continues to be the responsibility of their licensee to ensure compliance is achieved. Generally advisers are required to complete a minimum number of Continuing Professional Development (CPD) points each year as a part of achieving compliance with their licensee's requirements. This includes updates on changes to legislation and is typically of a technical nature. It is observed that the interpretation of what is required of advisers differs considerably across the breadth of licensees in the market, perhaps reflecting uncertainty on exactly what ASIC expects with regard to acceptable advice quality.

Paragraph 156 of the ASIC Review lists five factors that ASIC considers affect advice quality:

- a. Adviser incentives;
- b. Inappropriate scaling of advice;
- c. Lack of strategic life insurance advice;
- d. Weak rationales for product replacement advice; and
- e. Failure to consider the relationship between life insurance and superannuation.

It is appropriate to address each of these topics in adviser education and culture with only the first, adviser incentives, reflecting issues relating to remuneration. Whilst recognising many advisers are satisfactorily meeting all of the requirements, it is important to address how to ensure all advisers are aware of their responsibilities and how to meet them.

This raises culture as an important consideration. It has been pointed out earlier in this report that life insurance advice has evolved from an historical emphasis on product sales. This evolution has progressed towards a focus on strategic advice that considers the specific needs of each client and may also include product recommendations that are appropriate to meet those needs. However, there are opportunities to further improve the culture that surrounds life insurance advice.

To illustrate how culture can play a significant role in advice quality, it is useful to understand how advisers are authorised to provide advice. Advisers are generally authorised to provide advice on one or more specific disciplines such as insurance, superannuation, investments, direct equities or self-managed superannuation funds. Once authority has been granted to advise in a specific discipline, it is often a challenge for the licensee to succeed in limiting an adviser to service only those advice client scenarios that are within the degree of complexity that the individual adviser's level of competence and experience can handle.

It therefore becomes critical that the culture surrounding financial advice encourages individual advisers to act prudently when faced with complexity that exceeds their own current level of competence. This may take a number of forms including:

- Seek support from a more experienced peer;

- Seek support from a technical team within the licensee or product provider;
- Refer the client to a more suitable adviser given the complexity involved; or
- Decline to provide advice to the client;

It is essential that advisers are not tempted to provide advice outside their level of competency. As this is difficult to monitor at the licensee level or through legislation and regulation a cultural norm that is needed across the advice market that advisers seek support or decline to offer advice when faced with cases that exceed their level of competence.

The importance of adviser education in creating this cultural norm should be considered. One aspect is the role of ethics in adviser education. There are several initiatives currently being explored in regard to ethics training as a compulsory component of adviser training. It is a prominent part of the curriculum in both the AFA's premier designation, the Fellow Chartered Financial Practitioner (FChFP) and also the Financial Planning Association (FPA) Certified Financial Planner (CFP) designation. Ethics also plays an important role in the Codes of Conduct of both the AFA and the FPA. It is notable, however, that a significant number of Australia's financial advisers are not a member of a professional association.

A further aspect to consider is the training of individuals whose actions influence advisers. These may be business development managers or executives working for insurers, leadership and compliance people within licensees, or owners or senior advisers within advice businesses. If we accept that culture represents the sum of behaviours from a group of people, then it becomes clear that those that influence advisers need to be included when considering training and education.

For new advisers entering the profession and those with limited experience in providing strategic personal financial advice, it may be useful to consider the role that mentoring or supervision could play in their development. Given that much of current adviser training is of a technical nature, mentoring has the ability to bring together theoretical concepts with practical advice based on experience that can be of significant value in the development of an adviser.

This thinking can be taken further to include peer review whereby an adviser accesses the knowledge of other advisers in testing their thinking or recommendations on cases that sit outside their current level of expertise. This can be of particular value in situations where the adviser doesn't know what he or she doesn't know. In other words, there may be aspects of the law, the product or the client's circumstances that a less experienced adviser may unconsciously miss that a peer is able to recognise and draw to the attention of the adviser.

Another element to consider is the ability of individual advisers to access and then efficiently use software including comparison, ratings and modelling software. By virtue of decisions made by their licensees, not all advisers have access to appropriate software but where access is present, it is useful to consider how effective or useful it is in supporting strategic advice.

Questions

We pose the following questions with regard to adviser education and culture:

- For existing advisers, how can licensees and other stakeholders ensure that they have the knowledge, skills and tools to provide quality strategic personal life insurance advice?
- What training options are available to deliver a quantum increase in the minimum level of adviser competency with regard to personal life insurance advice?

- For new advisers entering the profession, what oversight, support and training would enable them to provide advice at the quality expected?
- Is it appropriate to consider a training requirement for the compliance teams within licensees with regard to ASIC's strategic advice expectations?
- Are licensees supporting advisers adequately to attain appropriate knowledge, skills and tools to provide quality strategic personal life insurance advice?
- What are the options to enhance the culture surrounding advice?
- Would it be appropriate for the industry to fund the development and delivery of a risk advice training course and make it available through licensees for completion by each of their advisers as well as employees holding a compliance supervision role?
- Should there be greater emphasis in training placed on an understanding of the implications of product replacement?
- Should training on client behavioural biases be included in adviser training?

3.3 REGULATORY OBLIGATIONS AND CONSTRAINTS ON ADVISERS

The topic of statements of advice (SoAs) has been identified as a major aspect of both the obligations on advisers and, in view of all the regulatory constraints on advisers, how they affect the quality of advice.

Inherent in the receipt of good client advice is clear, succinct and accurate transmission of information and advice from adviser to client. The regulatory requirements around SoAs and the current practices of licensees and advisers in preparing them can be seen as an impediment to effective communication and delivery of advice to clients.

To elaborate, as part of the conduct and disclosure obligations set out in the Corporations Act, personal advice providers (such as licensees or authorised representatives) are required to provide an SoA to retail clients to whom they provide personal financial advice. The purpose of an SoA is to provide retail clients with the advice, together with as much detail as reasonably required to enable a client to make a decision whether to proceed with the advice.⁹ The Corporations Act sets out a whole range of extensive content obligations that must be included in an SoA.¹⁰ This includes information about:

- the advice;
- the basis on which the advice is given;
- remuneration information including benefits that may be capable of influencing the advice (including any benefit received by the providing entity, related body corporate, director or employee or any associate);
- information about any other interests, both direct and indirect, that are capable of influencing the advice;
- a range of other content requirements where the advice includes a recommendation to replace a product with another (e.g. any charges incurred in the disposal or acquisition of

⁹ ASIC Regulatory Guide 175 at RG 175.159

¹⁰ Corporations Act 2001 (Cth) s947B, s947C and s947D.

the product, any benefits lost, any other significant consequences for the client in taking the recommended action etc); and

- ASIC provides regulatory guidance on its approach to the legislative requirements, information it expects to be included in the SoA, and sets out further details on what should be included in the SoA to meet the relevant obligations set out in the Corporations Act.¹¹

The SoA must also be clear, concise and worded and presented in an effective manner.¹²

Failure to provide the client with an SoA or provision of a defective SoA (e.g. an SoA that includes an omission of required information) amounts to an offence under the Corporations Act 2001. This may subject the advice provider to administrative sanctions, civil penalties or civil actions.¹³

Feedback from advisers and others who prepare SoAs has indicated that most SoAs relating to insurance advice are lengthy and are typically over 20 pages in length (for insurance only – any investment advice is another 20 pages or more). Underlying the length of SoAs is feedback that the documents (usually templates which are commonly provided by the adviser's licensee) contain lengthy sections of standardised disclosures and disclaimers, whereas the tailored, client specific advice section is relatively brief. The contents of the SoAs are considered necessary to meet the adviser's legal obligations as determined by the licensee and which in many cases are designed to protect the licensee and the adviser from being the subject of legal action by the client.

An important consideration around the SoA is the cost to the advice business of creating and providing the document in a compliant format.

ASIC provided an example of a 13 page SoA in Regulatory Guide 90 (released in August 2013) to illustrate what a short and concise SoA may look like. The example SoA was limited to a scenario that did not require a full financial plan and instead related to the provision of scaled advice. The objective of the sample SoA was to demonstrate good disclosure practice, not best disclosure practice, that satisfied a 'basic level of disclosure and complies with the law.'¹⁴ Despite regulatory guidance on what a shorter SoA may look like, the industry continues to produce lengthy SoAs.¹⁵

Given the extensive obligations imposed in relation to SoA requirements, as well as the severity of implications arising from failure to provide a compliant SoA (amounting to an offence under the Corporations Act), it is understandable that a thorough approach be taken when preparing an SoA.

¹¹ 'a generic description of the range of financial products, classes of financial product or strategies considered and investigated; a concise statement of how the advice provider has acted in their client's best interests; the reasons why the advice and recommendation were considered appropriate, including in light of the alternative options considered, and the advantages and disadvantages for the client if the client follows the advice'; disclosure if the recommendations are restricted to products from the Approved Product List; set out any tax and significant risk considerations etc; ASIC *Regulatory Guide 175*, pages 42-52.

¹² *Corporations Act 2001* (Cth) s947B-947D.

¹³ ASIC *Regulatory Guide 175* at RG 175.191 and 175.205.

¹⁴ ASIC *Regulatory Guide 90* at page 4.

¹⁵ 'In 2005 ASIC produced its first shorter SoA at 13 pages which drew some industry criticism. In 2009 ASIC Regulatory Guide 200 provided three further examples of two-to-three page sample SoAs. In July 2011 ASIC released five SoA examples of two-to-three pages. In August 2012 it released ASIC Consultation Paper 183 with a further 10 examples of two-to-four page SoA's. ASIC's latest example in August 2013 under Regulatory Guide 90 provided another 13-page SoA document' source Keenan (2014) Why it's time to standardise statements of advice.

However when one considers the findings of research undertaken by ASIC in Report 224, that advice documents are often long and complex and that 62% of consumers have a preference for written advice that is no more than 3 pages in length¹⁶, then it is worth exploring this issue further. This may have profound implications for the cost of preparing the SoA.

Questions

- How could SoA's be better structured to meet the spirit of the law on conduct, disclosure and the Best Interest Duty?
- Given that lengthy disclosure is common in most SoA's, and most consumers prefer shorter written advice, are there more appropriate ways for informed client consent to be obtained than via just the SoA?
- What amendments to legislation or regulation might be required to improve the effectiveness of SoA's and therefore make them more efficient to produce?

A further question arises regarding SoAs when a client's needs or circumstances change such that the adviser and the client decide to review and make changes to the client's insurances. Whilst we note there are some limited circumstances where a 'Record of Advice' can be used to scale back the full SoA process (such as when an insignificant change is made to the client's insurance cover eg less than 10% change in the sum insured with the current insurer), a significant number of reviews result in a full SoA being required. This is expensive for the adviser and often frustrating for the client. In some cases, the adviser will seek compensation for the time involved in amending the insurance advice by way of switching the client to a new insurer and/or policy where new commission is earned.

It is useful to consider how the review of an existing client could become a more efficient process for the adviser and a more valuable service for the client. Additionally, we can consider the effect on lapse rates that could be achieved if insurers had more flexibility in increasing sums insured on existing policies.

Questions

What could insurers do to make it more efficient to increase cover for an existing client?

- Is it possible for an insurer to underwrite only on the basis of changes in health since the last full underwriting assessment was made on the client, thus shortening the time required for collection of relevant health information?
- Is there a case for revisiting the SoA requirements for insurance policies that are in force when client circumstances change?

For example

- Is the idea of expanding the ability to use a 'record of advice' one that warrants developing further? Are there other effective options?
- To what extent could the industry make the changes without resorting to legislative change?

¹⁶ ASIC Report 224 (2010) *Access to financial advice in Australia*, pages 63 -64.

3.4 COMPETITIVE CONSTRAINTS ON ADVISERS

A prominent issue regarding constraints on advisers relates to *Approved Product Lists* (“APLs”). As explained in Chapter 2 each AFS licensee makes its own determinations as to which platforms, investment products and life insurance products are on its Approved Product List. Its financial advisers are then largely limited to offering only those products that are on the list. There are exceptions: the adviser can ask the licensee for permission to use a particular product not on the list and clients can also specifically request alternative products. Nevertheless in practice most advisers typically recommend products within the APL.

The selection of platforms in an APL plays an inter-related role with the access to insurance product choices for an adviser. For example, for insurance recommendations to be held inside a superannuation account, only a very limited number of insurance products may be available to that platform. Some platforms only have one insurer available.

For investment products such as managed funds where there is a plethora of homogeneous investment choices for each investment class, it is hardly surprising that the list on an APL is limited to some extent as advisers do not realistically need to consider the full list of such products to meet their advice duty.

It is important to note that limiting APLs is often important in obtaining and retaining cost effective professional indemnity insurance for licensees and their advisers. This is particularly the case with investment products but may have some effect with regard to insurance products as well.

In life insurance, however, there are only about 15 companies that offer retail products through financial advisers and who offer adviser support services (including underwriting processes and standard terms and conditions of cover, claims and administration services).

Given the small number of life insurers, external observers might expect to find offerings from several insurers and possibly from all insurers on each licensee’s Approved Product List. We find, however, that some licensees include only one, two or three insurers on their list and, in cases where the licensee is owned by a life insurer or related entity such as a bank, the list may exclude the products offered by a many of their competitors.

It is useful to consider how a limited APL may exclude an adviser from easy access to the products or services of more innovative insurers that offer more efficient or competitive services. These services may relate to better response times on underwriting, renewals and enquiries generally, better modelling or quoting software, tele-underwriting services, specialist underwriting services, more efficient claims handling, contract terms or pricing.

It is not unusual for an insurer to pay a fee to a licensee to support adviser training and education once placed on the APL. It is less clear how directly that training supports quality strategic life insurance advice training versus product knowledge training but both are appropriate as advisers are required to understand the products that they recommend.

Questions

These practices on APLs raise some important questions:

Explanatory questions –

- Is it the case that some licensees' Approved Product Lists are restricted in such a way that they could compromise their adviser's ability to act in the client's best interest or otherwise to compromise the advice?
- Do tightly restricted APLs pose competition issues to the detriment of the client?
- Do advisers understand their obligations with respect to considering products outside the APL in addressing the advice needs of each particular client? Further, do advisers have to regularly satisfy themselves that their licensee has an appropriate product list?

Reform questions –

- Is there a case for requiring a minimum level of open-architecture for Approved Product Lists with respect to life insurance products?

4. OPTIONS FOR REFORM: ADVISER REMUNERATION AND OTHER INCENTIVES

As already noted, ASIC has recommended that insurers “address misaligned incentives” and “review their remuneration arrangements to ensure that they support good-quality outcomes for consumers and better manage the conflicts of interest within those arrangements.” It also recommends that AFS licensees “ensure that remuneration structures support good quality advice that prioritises the needs of the client” and that they “review their business models to provide incentives for strategic life insurance advice”.

In seeking to address these issues in a way that provides a meaningful change to industry culture and practices, and prevent or mitigate consumer detriment, we need to consider both direct remuneration (commission) arrangements and other adviser incentives.

The rationale for considering removal of high up front commissions as part of adviser direct remuneration is articulated in the ASIC Review.

It is evident that with upfront commissions, whether of the “full upfront” or “hybrid” variety, there is a financial incentive for advisers to arrange for clients to be insured (a good thing in general providing the client’s coverage needs and affordability criteria are properly met). There is also a financial incentive to replace a client’s existing policy with a new one (which can be appropriate or not, depending on client circumstances and insurer offerings).

It has been noted by ASIC that there is a clear ‘first mover’ disadvantage for insurers attempting to unilaterally change or significantly reduce their commission structures. This essentially prevents any individual insurer from “breaking the cycle”, no matter how interested the insurer may be in rationalising its commission arrangements. To interrupt the cycle would therefore require an industry-wide initiative, whether taken by the life insurance industry itself or by government intervention. It is acknowledged that support of the ACCC would be required for such an industry-wide self-regulatory response to be achieved.

Evidence of the need to consider a change to direct remuneration practices has been provided by ASIC, and further input has been provided by the FSI report (see Box 3). With the emphasis placed on this subject by ASIC, a related recommendation within the FSI and the recognised problem of substantial initial commissions that constitute a conflict of interest of some materiality for advisers, it is essential that this topic be examined and considered in some depth.

The rationale for considering other (non-commission) adviser incentives is two-fold: (1) because other adviser incentives can create real or perceived conflicts of interest for advisers that may impact on the quality of advice; and (2) to ensure that in the implementation of any future changes to remuneration practices there is a thorough consideration of any broader issues (which may not always be obvious or apparent) or unintended consequences that may impact on the quality of advice or competition within the life insurance industry.

As other adviser incentives have attracted seemingly less attention from regulators, at least in the context of ASIC’s report and the FSI report, the bulk of the discussion on other adviser incentives is exploratory in nature, with questions posed in order to establish a base of evidence on these issues for the final report.

Box 3 – ASIC and FSI views on direct remuneration arrangements

On upfront commissions ASIC notes –

“High upfront commissions give advisers an incentive to write new business. The more premium they write, the more they earn. There is no incentive to provide advice that does not result in a product sale or to provide advice to a client that they retain an existing policy unless the advice is to purchase additional covers or increase the sum insured.” – Para. 147

On the first mover problem ASIC notes –

“...an individual insurer may change its remuneration arrangements to mitigate the effect of conflicts of interest amongst advisers selling their policies, but is likely to lose business to competitors.” – Para. 21

In acknowledging the ASIC review and its findings, the recently released FSI report has added to the debate with the following introductory observation –

“In light of recent evidence, the Inquiry is concerned about high upfront commissions for life insurance advisers. This has been a longstanding industry practice reflecting that life insurance has higher arranging costs, such as managing the underwriting process, and that consumers are often not independently motivated to purchase life insurance. With the exception of group life insurance policies inside superannuation and an individual life insurance policy for a member of a default fund, life insurance products are exempt from the FOFA ban on commissions. This allows individual life policies to be sold with high upfront commissions, creating an incentive for advisers to make a sale, rather than provide strategic advice. For example, these policies can have 100–130 per cent of the first year’s premium payable as upfront commissions, with an ongoing trail commission of around 10 per cent.”

ASIC concludes that a response is required but is silent on the best way to respond –

“Our findings in this review indicate that the impact of adviser conflicts of interest on the quality of life insurance advice is an industry-wide problem. Addressing this problem will require an industry-wide response.” – Para. 22

The FSI goes further than ASIC by recommending a particular response:

“For life insurance, the Inquiry recommends a level commission structure implemented through legislation requiring that an upfront commission is not greater than the ongoing commission. This would provide a balanced and cost effective approach to better align the interests of advisers and consumers.”

4.1 DIRECT ADVISER REMUNERATION

4.1.1 COMMISSIONS: CURRENT INDUSTRY PRACTICE

For reference, commission arrangements are typically one of three types as follows -

“Upfront commissions” or “Full upfront commissions”:

100% to 130% of the Year 1 premium and 10% of all subsequent premiums

“Hybrid commissions” (lower upfront commissions and higher subsequent commissions than “full upfront”):

75% to 90% of the Year 1 premium and 20% of all subsequent premiums

“Level commissions”:

30% of each year’s premiums.

Each of these models is operating in the industry, with some 80 per cent of policies sold with full upfront commissions and a growing proportion now on hybrid commissions. Level commissions are a small proportion of the total.

4.1.2 DISCUSSION OF OPTIONS AND IMPLEMENTATION ISSUES

GOALS AND CRITERIA FOR ASSESSING OPTIONS

In considering alternative commission arrangements it is useful to identify some goals and some criteria to met by any future new arrangements.

The ultimate goals are to ensure quality advice for consumers and improved insurance coverage for the community. Hence any restructuring of commission arrangements will need to be supported by the life industry and the advice industry. They will also need to be capable of endorsement by regulators, particularly ASIC and the ACCC (assuming a self-regulatory approach).

The following list of additional criteria has been suggested:

- a) Clear and simple to communicate to stakeholders;
- b) Capable of ready implementation;
- c) Encouraging behavioural and cultural change in the industry by minimising conflicts of interest and supporting quality advice outcomes;
- d) Sustainable over time for insurers, licensees, and advisers;
- e) Supportive of innovation and competition in both the life insurance industry and the advice industry; and
- f) Transparent.

NARROWING THE RANGE OF OPTIONS

Numerous alternative arrangements could be proposed and specified as reform options. Then, once specified, they need to be explored from an implementation perspective in two phases. The first phase is to consider the *reform position* (say three to five years out) to be achieved once a transition period has passed, which would include consideration of the impact of the change on consumer outcomes and the advice industry. The second or *transition phase* would be to look at how the transition might be constructed to carry us from where we are today to the proposed reform position.

The case for commissions generally on life insurance products has been made in numerous places, most recently in the FSI. Hence the case has been widely accepted outside the insurance and advice industries in order to encourage the giving of advice and the selling of life insurance cover. It is supported by the general belief across the community that insurance against premature death, disablement, illness and other vicissitudes is an important service to both the individual, and to governments.

To set some boundaries in this report, we rule out the option of continuing with the most common arrangement where initial commissions exceed 100% of the first year’s premium. There is sufficient dissatisfaction with these arrangements to dictate that this ‘no change’ option is not acceptable. At the other end of the spectrum, a no commission arrangement has not been actively considered in this interim report.

OPTIONS CURRENTLY BEING CONSIDERED

The main ideas or models identified in the research phase of this project that are worthy of consideration and debate as reform models are -

- **Level commissions only** (no extra commission in Year 1) and no other direct remuneration. Under this idea, the maximum commission rate itself would need debate and justification. We can assume that the rate would not be greater than 30% and could be lower.

Main argument in favour: all upfront commissions (including hybrid commissions) carry with them conflicts of interest that are difficult to manage in all cases and might be best avoided altogether.

- **Current hybrid commissions** as the maximum commissions (for example, dictating that the maximum upfront commission be 80% with level continuing commission).

Main argument in favour: some degree of upfront commissions are justified because of the high arranging costs of insurance but the current norm of around 120% initial and 10% ongoing commission is distortive while say an 80%/20% arrangement is better balanced.

- **Modified hybrid** comprising initial remuneration of a combination of commission at a level less than the current hybrid plus a fixed dollar payment. Renewal commissions could be as per current hybrid arrangements

Main argument in favour: retains the essence of existing hybrid arrangements that offset the upfront expenses of advisers but ameliorates the problem of initial commissions that seem excessive on large policies and inadequate on small policies.

- **Level plus fees** comprising level commissions, at a rate to be considered, supplemented by an initial payment in the nature of a fee from the insurer to the adviser. Such a payment would not be a commission expressed as a percentage of premium but a dollar based fee in the nature of cost recovery or expense reimbursement.

Main argument in favour: introduces level commissions, with their consequent avoidance of conflict of interest, while simultaneously maintaining an initial payment that is “unbundled” in order to offset an adviser’s initial costs of providing advice.

- **Level funded** as a variation on ‘level’ whereby the commissions are level but the insurer lends the adviser funds equal to 50% of the first year’s premium (in addition to paying level commission) and allows the loan to be repaid over say 3 to 5 years from renewal commission.

Main argument in favour: Upfront commissions are seen as undesirable but the adviser’s cash flow is a genuine issue that needs a solution.

In assessing these options, consideration should be given to the short run and long run sustainability of advised life insurance at all levels: product provider, licensee, adviser and client. A solution which makes it too difficult or unrewarding for one or more of these parties to participate in the provision of life insurance will ultimately disadvantage all parties.

It should be noted in considering these models that they are conceptual and are not fully specified at this stage. Any of these models were selected as a reform option would necessarily be part of a more comprehensive model design and belong to a package of proposals that would also encompass matters of advice quality, indirect remuneration and other incentives, insurer product offerings and productivity measures.

DIRECT ADVISER REMUNERATION: CLAWBACKS AND RESPONSIBILITY PERIODS

It is evident that anything other than level commissions requires a complementary solution to the “churn” or inappropriate replacement policy problem, whereby a new policy can attract a new upfront commission or fee payment when there is no material net benefit to the client. This problem has two elements. One is that the insurer is heavily out of pocket if the policy only runs for a limited period, say up to 3 or 4 years, and cannot retrieve any commissions already paid. The other is that the financial incentive on the adviser to replace an existing policy is high.

We note that premium increases, change in circumstances, regulatory changes, competitor policy improvements or pricing changes can all result in client-driven changes of policy which are in the client’s best interest, and achieves payment for the adviser, yet may cause losses to be experienced by the insurer. In other words not all replacement advice is inappropriate.

A current solution to the problem of short term policy lapses is some form of “clawback” or responsibility period such that, if the policy is not continued during the responsibility period, some or all of the commissions already paid to the adviser are clawed back by the insurer. The industry standard responsibility period is currently one year and the clawback amount may be pro-rated after the first six months by some insurers.

Questions

If any of the alternative models identified above that includes a form of upfront payments were to be supported we could ask –

- Should there be a ‘responsibility period’ on the adviser whereby some part of commissions and fees already received at the time of policy lapse or replacement are clawed back by the insurer?
- If so, what kind of clawback formula might be appropriate?
- How long should the responsibility period be?
- Should any form of upfront commission be available to new clients only with replacement business remuneration models being restricted to level commission only?

DETAILED EXPOSITION OF OPTIONS

The five alternative models can be explained further as follows –

Level

This model is the simplest. There is no financial incentive on the adviser to replace an existing policy and the question of clawback or responsibility period does not arise in a significant way.

Its major drawback is the obvious one that, by failing to offer advisers compensation for or reimbursement of any of their upfront costs in advising clients, it may prejudice levels of sales of life insurance, thereby disadvantaging both consumers who do not purchase the protection they should and the viability of the advisers who, under a different model, would remain active in advising on and arranging the purchase of life insurance.

An important feature and indeed the main feature to consider for this model would be the level of commission that would apply. This debate is not pursued here beyond the suggestion that the maximum level commissions that should apply would be between 30%, being the normal current rate for level commission policies, and 20%, being the normal renewal commission applying in the hybrid model.

Hybrid

This model is well understood because it exists in today's market. While having a lower upfront commission than "full upfront", typically it has twice the level of renewal commission (20% instead of 10%). As a result, it is attractive to advisers who are satisfied with the lower upfront commission because of the higher renewal commission, which represents a higher continuing income a higher value for their or their employer's business and perhaps a better reflection of the costs of client renewals.

An important consideration under this model is the responsibility period. Current practice is one year. Some of the proponents of the argument to retain a hybrid model believe that the responsibility period should be extended to 3 or 4 years.

The one-year clawback is an aspect which is widely regarded as contributing to the problem of the inappropriate replacement of policies (see further below).

Modified hybrid

As already noted, this model would ameliorate the problem of what some regard as excessive upfront commission payments on large policies and inadequate upfront commissions on small policies.

By way of example, assume that the commission formula is 50% commission plus \$500 upfront instead of 80% commission. We would then have

Annual premium	Year 1 Remuneration (Commission plus fee)	
	Hybrid	Modified hybrid
10,000	8,000	5,500
3,000	2,400	2,000
1,000	800	1,000

Note that the average premium across the industry is generally thought to be around \$2,500 to \$3,000.

Particularly in relation to lower value premiums, this model may be criticised for delivering the equivalent of a high up-front commission and therefore not genuinely addressing the concerns identified in ASIC's report and the FSI.

This model is one that could be explored further if the general principle of the current hybrid model is to be retained but with refinements aimed at improving its suitability across the spectrum of clients.

Level plus

This model is conceptually different from the hybrid or modified hybrid model because of the unbundling involved.

Although the insurer would still be making upfront payments, because the payments are in the nature of a fee not a commission, some important differences are attached –

- The fee, presumed as not subject to clawback, means commissions per se would be level, with the benefits that would bring regarding removal of conflicts of interest.
- The commissions would be lower than 30%, in view of the fee, and could conceivably be set at 20% (the current hybrid level for renewals).
- Being different in character from a commission, this fee has the potential to be accepted by consumers and others, including the critics of upfront commissions, as a form of level commission product. The alternate risk is that it is simply seen as commission by another name.

This model would need to be carefully calibrated in order to ensure that the fee did not end up replicating the same incentive as an up-front commission today, particularly if it is excluded from any claw back. It may be that a scale of fees would apply depending on the complexity of the case and the large or small size of the policy premium.

Level funded

The primary virtue of this model is that it is a level commission model, with the benefits that go with level commissions, and it solves the short term funding gap that exists for the adviser between the cost of providing initial advice and the rate of level commission payment. It effectively advances some future commission payments to the adviser at the time the policy is written.

The repayment of the loan would come through the insurer withholding some proportion of renewal commission payments until the loan was repaid. A loan might be interest free for simplicity of management.

Overall, this approach is more complicated than the other models because each policy would need to be accompanied by its own loan. For the model to work, noting that many advisers use more than one insurer, it would require a level of administration that is significantly greater than other models and it would lack the transparency of other models. The loan obligation would also potentially provide a problem in that it could create its own conflict of interest and might be leveraged by the insurer. A further complication would arise on the sale of a business or book of clients should an adviser leave the industry.

This idea is included for completeness, to illustrate that there are other ways to design an adviser remuneration system, but in view of its complexity it is not considered further in the analysis below.

Questions

Outlined above are four models that it is proposed be considered further and that would involve considerable restructuring of existing commission arrangements. There are two sets of questions: comparative questions aimed at drawing out the differences between the models, and stand-alone questions aimed at seeking a richer analysis of each individual model.

Stand alone

- What are the pros and cons of these models? What are the costs, benefits, trade-offs and sustainability of the alternatives, including impacts to both existing participants (insurers, licensees, and advisers) and new participants wishing to enter the market.

- What would be the consumer impacts with the respective models?
- Which models have the most potential to minimise adviser or licensee conflicts of interest and maintain or increase, through the efforts of advisers, insurance coverage across the community?
- What is the impact on the valuation of an adviser's business under this model?
- To what extent can fee for service arrangements replace forgone commission income? What relevant insights can be drawn from those that already operate under a partial or full fee for service model?
- Are there any consumer obstacles to moving towards a particular model? To what extent are they relevant?
- The extent to which this option will provide an incentive for the provision of non-product-specific advice or strategic advice?
- What is the impact on premiums of the various remuneration models – i.e. is there any change in premiums that would be expected?
- Which of the above options (or combination of the above) would be your preferred reform model? Are there any other alternative models that should be considered?

Comparative

To simplify this comparative assessment of the models, the table below nominates in the right-hand column the models under which the question in the centre column should be considered, using the code L for level, H for hybrid, M for modified hybrid and L+ for level plus. The funded level model is not considered.

1	Is this model feasible in a way that would avoid materially reducing the community coverage of life insurance and maintaining the viability of independent advisers?	L H M L+
2	How might the fee element work, given that it is essentially a novel concept in life insurance that to the best of our knowledge has not been applied in other markets?	L+
3	What are the relative merits between unbundling the upfront remuneration as a fee and paying an additional commission?	H M L+
4	Some clawback may be needed in all variations of the hybrid model – • to what extent would continuation of a one-year clawback be seen as dealing with “misaligned incentives”? • how important to policy persistency is an extended clawback period? • how workable, fair, and effective would an extended clawback period be, given the problems of customer- initiated lapses arising from changing customer circumstances (which can lead to abandonment of insurance or to switching to another product better suited to new circumstances) and commission rebates that some advisers offer?	H M
5	As clawback does not arise under the fee element of the Level plus model, how important is the presence or absence of clawback to the insurer and to the adviser?	L L+
6	How effective might the fee idea be in achieving reasonable compensation for advisers in place of the conventional extra 60% front end commission under the current hybrid model?	L H M L+

7	Can this model be designed, in conjunction with a range of initiatives designed to eliminate or reduce non-commission incentives, so as to maintain a level playing field as between aligned and non-aligned advisers and between employed and self employed advisers?	L H M L+
8	How would this approach translate into enhanced consumer outcomes, with specific reference to pricing, quality of advice, access to advice, trust and transparency?	L H M L+
9.	How well will this model work to support referral and joint venture arrangements between financial advisers and accountants, mortgage brokers and other sources of client referral?	L H M L+
10	How likely is it that this approach would be seen as an attempt to preserve too much of the status quo, thereby essentially retaining intact current industry remuneration practices. or, equivalently, would this model represent a sufficient level of structural change to demonstrate material change in industry remuneration practices and the elimination of “misaligned incentives”?	L H M L+

IMPLEMENTATION MECHANISM FOR THE REFORM MODEL

A fundamental question is whether, whichever reform model is chosen, there is a need for government regulation or, as is the preferred position of the insurance industry, the advice industry and the regulators, a self-regulatory framework can be developed and sustained in the mutual interests of community, the advice industry and the life insurance industry.

Self-regulatory industry action in order to shift to one of the reform models discussed in this chapter would need to avoid breaching the competition provisions of the Competition and Consumer Act 2010 (Cth). Such action may be possible through an industry agreement that is given authorisation by the ACCC (see Box 4).

Box 4: The ACCC Authorisation Process

Parties that wish to engage in conduct which is at risk of breaching certain of the competition provisions of the Competition and Consumer Act 2010 can seek statutory protection by seeking an Authorisation from the Australian Competition and Consumer Commission (ACCC). Generally, the ACCC can grant authorisation if it is satisfied that the public benefit from the conduct outweighs any public detriment, including any lessening of competition. Any industry self-regulatory response relating to direct remuneration options would need to seek such an Authorisation.

Question

- Could the preferred reform model be introduced and operate effectively on a self-regulatory basis, if ACCC authorisation were forthcoming, without the need for government legislation or regulation?

TRANSITION TO REFORM MODEL

Transition requirements would not be the same for all models. Some of the more easily recognised transitional requirements or elements of a transition plan might be –

Level Commission

It is likely that this model would need to be implemented progressively over 3 to 5 years. For example, new policies might attract upfront commission of say 80 per cent in Year 1 (perhaps 2016), 60 per cent in Year 2 and 40 per cent in Year 3 with full level commissions being introduced in year 4.

Hybrid

As this model already exists, it is the one that would yield the most straightforward transition. It might be possible to move directly to this model in year 1 (perhaps 2016), simply by “outlawing” upfront commission in excess of 80 per cent of the year 1 premium.

Modified hybrid

This model could possibly be introduced on the same time horizon as the hybrid model because of its similarity to the hybrid model and hence some design simplicity

Level plus

This model would require more design and implementation investigation and planning than the other models. Two possible pathways to its introduction may be –

- Direct implementation once design is completed, that is by 2016 or 2017;
- An intermediate move to hybrid or modified hybrid in 2016 until the level plus fees model is introduced in 2017.

For each model an effective transition will be one that keeps insurers and advisers engaged such that the community insurance needs are not prejudiced in any way during the transition phase.

Questions

- What are the priority considerations in planning a transition?
- How might a transition plan be structured as to transition steps and timing?
- What would be the main risks and the main costs in working through the transition phase?

4.2 OTHER ADVISER INCENTIVES

As previously mentioned at the start of this chapter, there is a need to consider other adviser incentives separately in relation to how they influence advice quality. There is also a need to consider other adviser incentives in relation to how they influence the integrity of any changes to direct remuneration in respect of transition and end state. For simplicity, these issues are covered separately in the paragraphs below although they are intrinsically linked to the quality of advice.

Other adviser incentives include relationship benefits (e.g. premium underwriting services), preferential terms (e.g. reduced loading on non-standard policies), incentives to use aligned

products (e.g. buyer of last resort arrangements; reduced licensee fees). It should not be presumed that these arrangements automatically create misaligned incentives.

Discussion in Chapter 2 also alluded to two categories of advisers, “aligned” and “non-aligned”¹⁷, as well as a number of practices relating to indirect payments (such as “shelf space” fees, volume bonuses, marketing payments and sponsorship payments), “back-office” support or subsidisation and APL access. These structures and practices may, to different degrees, create real or perceived conflicts of interest along the value chain and thereby affect the quality of advice.

Based on cases cited in its Review, ASIC evidently sees a connection between advice standards and adviser incentives that potentially compromise the quality of advice. This problem exists because of upfront commissions but it is likely that it is not confined to the commission payment alone.

Questions

In order to achieve a fact base to consider these issues in and of themselves, and in light of implementation of changes to direct remuneration, submissions are asked to consider the following questions:

- Which non-commission incentive practices discussed in Chapter 2 create a conflict of interest (real or perceived)?
- Are there financial incentives given to practice development managers or other executives within the licensee that reward them for increased sales of “in-house” insurance products made through advisers, thereby influencing advisers within that licensee to sell more “in-house” products?
- Are advisers supported financially, directly or indirectly, such as in the “back office” or otherwise, and as a result offered more favourable terms for themselves or their customers on “in-house” products? If so, does this lead to consumer detriment?
- Do the financial incentives given to business development managers and other executives employed by insurers cause them to be influence outcomes inappropriately?
- Are there any internal practices within licensees currently that are designed to manage or mitigate these conflicts beyond the existing requirements under the law? Do these practices need to be expanded upon?
- Are specific changes needed in order to address these real or perceived conflicts? What form should they take? Could an industry code of practice (discussed in Chapter 5) address these issues if specific changes are required?

¹⁷ While there are various interpretations of what these terms mean, for the purposes of this report “Aligned” advisers are considered employed by or closely affiliated with the licensee or a dealer group that is owned by a life insurer, while “non-aligned” are considered to have no ownership connection or other preferential financial affiliation with a life insurer. Among “aligned” and “non-aligned” advisers, some regard themselves as neutral, depending on the nature of their relationship to the insurer and licensee concerned, and others are more clearly identifiable with the insurer and licensee. That is to say they believe they have practices in place that manage any real or apparent conflicts as a result of their relationships between licensees and insurers.

5. OPTIONS FOR REFORM: INSURER PRACTICES AND PRODUCT OFFERINGS

The activities and the business practices of both licensees and advisers are heavily dependent on the way that life insurers choose to operate their businesses and the range of products that they offer.

This chapter covers each of these two topics. The first question, which relates essentially to how the life insurance industry interacts with advisers and customers, is covered under the heading “Industry code of practice or charter” while the second topic is entitled “product offerings”.

5.1 AN INDUSTRY CODE OF PRACTICE OR CHARTER

In consultations, consumer groups expressed an interest in a code of practice for the life insurance industry. Other industry participants (insurers, licensees, and advisers) have also indicated an interest or a willingness to pursue such an initiative.

It is notable that both the general insurance industry and the banking industry have Codes of Practice, and indeed have had so for many years, but that the life insurance industry does not yet have anything comparable. Both the banking code and the general insurance code have been developed in the past to respond to various consumer and regulatory pressures that have been brought to bear following perceived adverse behaviour by institutions or adverse outcomes for consumers.

In view of the many issues identified in the ASIC review and considered above in this report on adviser quality, other adviser incentives and issues covered later on insurer product offerings, it is timely to consider whether the life insurance industry should follow suit and introduce its own code of practice. By way of illustration, it is useful to look at the aims and scope of the codes of practice of each of the general insurance industry and the banking industry, noting that in principle the scope of the general insurance code of practice is likely to be a useful indicator of a preferred scope for a life insurance code.

For *general insurance*, to quote from the website of the Insurance Council of Australia –

The General Insurance Code of Practice sets out the standards that general insurers must meet when providing services to their customers, such as being open, fair and honest.

It sets out timeframes for insurers to respond to claims, complaints and requests for information from customers.

The Code covers many aspects of a customer's relationship with their insurer, from buying insurance to making a claim, to providing options to those experiencing financial hardship, to the process for those who wish to make a complaint.

The Code is a voluntary code designed to guarantee exceptional customer service standards and to protect the rights of policyholders. It is monitored by the Financial Ombudsman Service.

It is set out in chapters that include such matters as buying insurance, standards for employees and authorised representatives, claims, financial hardship, complaints and disputes, information and education, code governance, monitoring and enforcement.

Similarly for *banking*, to quote from the website of the Australian Bankers' Association –

The Code of Banking Practice is the banking industry's customer charter on best banking practice standards.

The Code sets out the banking industry's key commitments and obligations to customers on standards of practice, disclosure and principles of conduct for their banking services. The Code applies to personal and small business bank customers.

An independent compliance monitoring body exists to investigate possible breaches of the Code. Anyone can refer a possible breach of the Code to this committee. In many cases a customer can also refer an allegation of the breach of the Code to the Financial Ombudsman Service.

Questions

The primary questions now arising in this context for the life insurance industry are –

- Should the life insurance industry establish its own code of practice for the benefit and protection of consumers?

If so –

- What should come within the scope of such a code of practice?
- As a voluntary code, what would be needed to make it effective in regulating the affairs of the industry in accordance with the goals of such a code?

5.2 PRODUCT OFFERINGS

Advisers can offer only those life insurance products that insurers choose to make available. The standard product range comprises one or more of four types of cover –

- life (or death) cover
- disability income (or salary continuance)
- TPD (total and permanent disablement)
- trauma.

These products are available on a stand-alone basis or in combinations, as indicated in Figure 1 in chapter 2 and expanded on below. The figures shown are estimates based on percentages given in ASIC's Review and estimated total annual premiums in force for advised business in 2014 of \$6.9bn.

Policy Type -2013	Market Share	\$billion
Life only	32%	2.2
Life and TPD	13%	0.9
Life and trauma	11%	0.8
Life, TPD and trauma	5%	0.3
TPD only	3%	0.2
TPD and trauma	1%	0.0
Trauma	9%	0.6
Income protection	21%	1.5
Income protection combinations	7%	0.5
Total	100%	6.9
Total life (alone and with other combinations)	61%	4.2
Total income protection (including combinations)	28%	2.0
TPD only	3%	0.2
Trauma only	9%	0.6

Hence we see that the majority of business is life only or life with the other covers included, while income protection is also a very significant part of the market.

We also observe product combinations starting to emerge as a result of regulatory and tax changes. An example is the changes to superannuation laws which have limited the types of income protection insurance cover able to be funded by a consumer's superannuation assets. This has led to a splitting of income protection cover by some insurers such that 'any occupation' cover is taken inside superannuation and 'own occupation' cover is taken outside superannuation. Insurers, superannuation providers and platform administrators, often within the same group, have designed solutions which enable customers to maintain comprehensive cover with optimal cashflow and tax benefits despite the new regulatory complexity. The bundling of life insurance with superannuation accounts has multiple benefits for consumers and product manufacturers. Bundled offerings are designed to deliver customer solutions that are as seamless as possible despite regulatory complexity. They can also assist advisers in making product choices in the best interests of their clients.

5.2.1 STEPPED AND LEVEL PREMIUMS

Generally these products are offered with either –

- “*stepped premiums*”, where renewal is guaranteed each year (i.e. no new health checks or additional underwriting) but the price will increase with the insured's age and with any increases in the level of cover

or

- “*level premiums*”, where renewal is also guaranteed but the premium stays constant for an agreed number of years.

The price for both stepped and level premium policies may be changed by the insurer with notice to the policy holder.

The majority of business is written on “stepped premiums” because the premiums are lower initially and it appears that most policyholders prefer to initiate the cover at the lower price and consider later the consequences of premiums that rise with age. These price rises by age are modest up to

age 35 or 40 but begin to increase more sharply in the 40s and 50s age groups. Increases at this point can commonly be 10% or 15% a year and rising plus any indexation (that also increases the level of cover each year). Prices at age 60 might be several times greater than the prices at age 40.

Most level premium policies are level from the age at issue until age 65 or 70. There are, however, some policies that offer level premiums beyond age 70 and some that offer level premiums for say 5 years only or 10 years only.

Stepped premiums can sometimes cause great difficulty for consumers. For policyholders who are in their 50s or older and who foresee a need to maintain their cover for a lengthy period, perhaps until death (for example in the case of funeral plans), the large increases that occur over time with stepped premiums often become problematic.

Therefore whilst stepped premiums may work well for many people up until their 50s, such that the choice of level over stepped can be freely left to consumers (and their advisers), it is questionable whether the same approach represents good practice or even acceptable practice by insurers for policyholders who seek to maintain their insurance through their 50s and beyond.

Questions

- Are there any aspects of policy design, particularly in relation to stepped premiums versus level premiums, that cause difficulties to advisers in maintaining advice quality, satisfying clients and dealing with insurers?
- Alternate forms of life insurance distribution (ie direct and group) where there is limited or no advice, offer stepped only policies. Given consumers are unlikely to understand the long term pricing benefits of level premiums, will they simply switch to other forms of life insurance distributed in a 'no advice' or 'low advice' arrangement?
- Should group and direct life insurance distributors be required to advise clients with existing insurance cover the advantages and disadvantages of replacing their existing cover, as to both underwriting risk and future premium projections?
- Calculating and understanding the long term benefits of level vs stepped premiums is complex and time consuming for the end customer who is often most interested in the cheapest premiums today. Can industry systems and platforms be upgraded to enable this problem to be more easily understood by consumers, including future premium projections as a standard requirement?

5.2.2 REPLACEMENT POLICIES

Clients frequently approach their adviser seeking to review their insurance needs with the specific request to lower their insurance premiums or to review their insurance when their life circumstances change, for example, new debt, a new child etc.

Where such requests lead to an increase in cover (for example, to increase the level of insurance or to seek additional cover such as critical illness or income protection), the adviser may choose to approach both the existing insurer and new insurers. Insurers generally limit the extent to which existing customers can increase their cover without undertaking full underwriting. Insurers of existing customers will only pay upfront commission on the increased cover whereas if the extended cover is provided by a new insurer, the new insurer will pay upfront commission on the total level of cover. The amount of time for the adviser, and effort by the customer, in being underwritten is largely similar with an existing and new insurer even if the increase in cover is relatively small. It is also possible the new insurer will have additional benefits for the consumer such as lower prices or enhanced terms, thereby making it attractive for the adviser and customer to seek a new insurer.

Replacement business is very costly to the industry in new upfront commissions each year which ultimately adds to the cost of insurance premiums and increases the risk of non-disclosure. There is a conflict of interest in the way the adviser is rewarded (replacement policy versus increases to existing policy). Sometimes the client is better off with a replacement policy but, as shown in the ASIC report, these benefits may not be significant vis-à-vis the risk involved.

The risk for the customer, and to an extent the adviser, is non-disclosure of new health issues during the underwriting process of replacement business. This does occur and at the time of claim assessment the new insurer may reject the claim given the lack of disclosure at the time of underwriting. With the original insurer, the claim may have been accepted given that that health condition did not exist at the time the original underwriting occurred.

Replacement business has been encouraged by life insurers through a range of practices in addition to the payment of upfront commissions. This may include special discounts or enhanced underwriting terms. It may also include bulk transfer terms with specialist teams to support the adviser in transferring multiple clients, which can occur for example when the insurer has acquired the licensee or the adviser.

Questions

- Does the existence of upfront or hybrid commissions on replacement policies influence the issuing of replacement policies over supplementary policies or increased cover on existing policies?
- Is there a “best practice” approach to replacement policies versus supplementary policies or increased cover on existing policies? For example, should upfront commission be banned or paid only once i.e. replacement business must be written on level commission only?
- Should an insurer accepting replacement business be required to provide a customer guarantee that any new health issues which would have been covered under the old insurance policy will continue to be covered under the new insurance policy, thereby transferring the non-disclosure risk to the new insurer?
- Do the benefits of allowing an adviser to replace business such as price and feature improvements for the end customer justify the risks to the client from non-disclosure and additional costs to the insurer of lapsed business?

5.2.3 INSURER FLEXIBILITY AND APPARENT BUREAUCRACY

Sometimes insurers introduce better products in the sense that they give greater coverage but they may also wish to charge higher prices. This may create a dilemma for both adviser and client – for the adviser on seeing a possible need for a replacement policy, for the client the need to investigate and decide whether to take any action or remain on existing cover. Sometimes of course extra protection is sought to cover changing family or financial circumstances.

Some insurers automatically put their existing policyholders into each new policy series, to avoid the complications of legacy problems where there are many different terms and conditions for the range of policies in the portfolio. Insurers who do not do this typically cite underwriting risk and pricing risk.

Question

- What is the range of issues arising from these practices for each of insurers, advisers and clients?

- Should life insurers allow product strategies such as automatic upgrading of existing customers to on-sale product terms to remove the differential which often exists between on-sale products and older products?

Advisers often lament that what would appear to be a simple change such as a 10% or 20% increase in sum insured calls for a full new SoA. In such cases, it is hardly surprising that advisers might recommend replacement of an existing policy over an increase or the purchase of a supplementary cover if there is no detriment to the policyholder in giving up an existing guarantee on renewal.

NB Stepped premium life policies pose some difficult issues for insurers that automatically flow on in some respects to advisers and policyholders. The difficult issue is around underwriting and selection. With all these policies offering guaranteed renewal, as each cohort of renewing policyholders contains the continuing policyholders who have not claimed, they will continue to pay premiums on the basis of the cohort to which they belong. The healthiest lives, however, may find that, if they seek other quotations, premiums on a new policy are lower than on the existing policy, simply because new policies are rated for healthier risks. In other words, there is some selection against the insurers by those who value the renewal guarantee (perhaps because of a health condition that emerged since taking up the policy), whereas those who do not value the guarantee (and that would normally include the healthiest lives) may switch to another insurer.

Questions

Are insurers unhelpfully defensive or unreasonably risk averse in not showing more flexibility on increases in cover on existing policies -

- Are insurers simply being prudent and protecting their whole portfolio and thereby their other policyholders? or
- Is it reasonable, for example, for policyholders to expect insurers to accept as part of the guarantee on renewal up to say a 20 per cent or 30 per cent increase in cover in any one year on the basis of an attestation by the client as to no adverse health event in the year and increasing needs (e.g. additional child or education fees, promotion, new mortgage or additional mortgage, etc)?

5.3 RATING AGENCIES

The rating agencies seem to concentrate on terms and conditions that are frequently referred to as 'bells and whistles' that insurers add to their policies to increase coverage in order to obtain higher ratings. The rating agencies don't appear to assess value, i.e. they don't take account of the extra price for the bells and whistles or the extra value added. These activities have the effect of creating a race for the top in ways which may have minimal customer benefit. Also they take account only of the formal terms and conditions of the policy and don't take account of service aspects such as efficiency, quality and timeliness of initial underwriting, claims services, underwriting at renewals for adjustments in cover, general enquiries etc.

A question arising in relation to ratings agencies generally concerns how conflicts are managed where a product rating review is funded by an insurer.

Questions

- Are rating agencies a positive influence or are they confounding some of the assessments that licensees need to make on products?
- Should the rating agencies be taking a greater interest in value for money and affordability to balance their assessments of policy coverage terms and conditions?
- How might the rating agencies make a better contribution to claims payment experience, customer service, product transparency, market awareness and product quality that would assist the effectiveness and reduce costs for licensees and advisers?

6. OPTIONS FOR REFORM: INDUSTRY PRODUCTIVITY

This interim report has already identified a number of potential initiatives that have productivity implications through the potential to increase adviser efficiency or to improve insurer efficiency or competitiveness. They would include –

- Simplified Statements of Advice
- Less restrictive Approved Product Lists
- Less lost time by advisers through adherence to a life risk professional standards manual that should contribute to advisers being better trained and better organised (specific examples might be improved practices around strategic life insurance and around replacement policies)
- Some simplification of commission arrangements and reduced conflicts of interest on new policies and replacement policies
- Improved life insurer standards of practice from the introduction of a life insurer code of practice.

There are a number of other measures that may be worth further consideration for increasing adviser productivity in relation to insurance advice involving a variety of stakeholders across the value chain. They include the following:

1. Providing consistency of insurance terms and conditions

Introducing greater consistency of insurance terms and conditions may assist consumers and advisers to better understand insurers' standard products. It may also assist insurance product comparisons between currently offered policies.

Such consistency would still need to retain flexibility on non-generic terms and enable product differentiation amongst insurance product providers.

Question

How beneficial and how practical is this idea? Could this be implemented by industry agreement?

2. CRM/Adviser Software

The use of customised CRM/Adviser software which is supported by template advice documents and workflow process management tools can create considerable efficiencies in the advice process and reduce the amount of time taken to complete the steps involved in the advice process (see Figure 3) as well as reduce the amount of time taken to generate a Statement of Advice.

It is important that sufficient flexibility is given in the creation of Statements of Advice to ensure that the adviser is able to customise and tailor the advice to the specific client's needs. It is a challenge to balance the need to provide standardised, easy to use, compliant and efficiently produced documents with the legal requirement to provide tailored advice.

Customised CRM/Adviser software is typically offered by licensees to their advisory network and the degree of customisation and support provided through the software varies between

licensees. Providing effective and efficient advice tools through the CRM typically requires resource and funding support by licensees.

3. Paperless/Online Applications

Paperless online application forms are becoming more common but are often inconsistent across insurers. Paperless online application forms may be available for a new insurance application but may not be available for increases in insurance cover where a separate paper based application form may need to be completed.

With respect to applications for increased cover on existing policies, client information which has already been provided to the insurer may need to be re-entered or completed again. Efficiencies could be gained by pre-populating existing client information into online applications for sum insured increases.

It would also aid efficiency if online applications from the insurers were in some way standardised or had consistent fields of required information. This may allow adviser CRM software to be customised to link directly to application forms and reduce the need for further data entry.

Implementing this idea would involve insurers offering pro forma or consistent online application forms, as well as providing online application forms with the ability to pre-populate existing client information.

4. Underwriting 'Quick Check'

The underwriting process can take considerable time, only for the adviser and client to subsequently find out in some cases that the client is unable to obtain insurance cover.

Having generic 'quick check' underwriting, after the initial client 'fact find' is completed could provide indicative and non-binding guidance on whether someone is likely to receive insurance cover from a particular insurer and could assist with overall productivity.

Such an option may require guidance from ASIC on whether an adviser and insurer would be permitted to provide such guidance to a client prior to a Statement of Advice being issued to the client. If the client is aware of which insurer has been approached, could this be construed as representing personal advice before the provision of the SoA?

Question

Are insurers likely to be able to assist licensees in developing a 'quick check' underwriting procedure?

5. Tele-underwriting

Tele-underwriting is offered by some insurers and involves the client providing information directly to the insurer. This reduces the amount of time the adviser spends with the client, thus creating efficiencies in the overall advice process, and also may assist with compliance and client disclosure.

Many clients and advisers value the relationship they develop by virtue of completing the personal statement together. This approach may be desirable in the eyes of the adviser or the client in some cases and undesirable in others.

Question

How effective is tele underwriting currently and how far can it be further developed in the interests of insurers, advisers and clients?

6. Medical underwriting and online access to medical reports

Similar to option five, obtaining client's medical report can take time. A limited number of health providers currently make client's medical reports available online which assists with speedy turnaround of information.

To make this option available more broadly doctors would need to upload reports so that they are accessible online.

Question

How feasible is it to enter into this approach widely and what resources would be needed?

7. Single online software portal for application forms which shares data with different insurers

Completing application forms can take considerable amounts of time. Insurers each have their own systems, processes and procedures for application forms. This requires advisers and their staff to learn different processes for each product provider which can further lengthen application form completion times.

From a technology and system perspective, offering a single online interface which enables a client's information to be entered into a single application, and the information is then shared with different insurers (which would match the data to the respective insurers system) would enable multiple application forms to be completed whilst only requiring data input once. This could further enhance adviser productivity.

Such an option would require such software to be developed and support from insurers to allow the software to link information with the insurers own system.

8. Automated Administration Notification

Some insurers offer automatic communication updates to advisers (for example via email) to notify the adviser that a client has updated their personal information. This is offered by some insurers only. It enables advisers to update their own client records and so increases administration efficiency.

This option would require support from insurance product providers to make this service widely available.

Question

Are insurers willing and able to fund and provide such a service?

9. Risk Data Feeds

Updated client information can also be provided to an adviser's financial planning software via data feeds from the insurer directly to the software and increases administration efficiency. This is currently offered by a few insurers only. The quality and depth of the information would need to include sub-standard underwriting decisions and the reasons for those decisions to make the data feeds useful at the adviser level.

This option would involve insurers making data feeds available with financial planning software providers.

Question

Are insurers willing and able to provide such a service?

The options canvassed above provide a variety of mechanisms for how productivity and adviser efficiency can be increased in relation to insurance advice. The ability to implement the options with ease and efficiency will however vary across the options, as well as the level of productivity gained.

APPENDIX 1 – TERMS OF REFERENCE AND BIOGRAPHIES

Life Insurance and Advice Working Group (LIAWG) Terms of Reference

1 Objectives

The LIAWG will review ASIC's report and make recommendations on how the industry can respond to the issues identified to ensure that Australians are adequately insured and receive world class financial advice.

2 Scope

The LIAWG will consider all options in its response including those which will be industry led and those which will require regulatory assistance.

The LIAWG will:

- Provide a unified response to the identified issues;
- Address the three key issues arising from the report:
 1. remuneration structures;
 2. product design issues; and
 3. quality of advice.

2.1 The LIAWG will provide specific analysis on the options and recommendations for industry change, including transitional paths.

3 Timing

3.1 The Working Group will provide an interim report by mid December 2014 and will report in early 2015.

4 Consultation

4.1 The Working Group will consult with key industry stakeholders, consumer groups, regulators and the Parliament.

5 Support

5.1 The Working Group will be supported by a Secretariat within the associations.

5.2 The LIAWG will have an independent chair, and will include a mix of advice, practitioner, and insurance representatives drawn from the founding industry organisations, the AFA and the FSC.

Biographies

Chairman – Mr John Trowbridge

Mr John Trowbridge has a background as a consultant, executive, company director and regulator in a career spent predominantly in the financial services sector, with an emphasis on insurance-related businesses. He started Trowbridge Consulting in the 1980s, which became a leading actuarial and management consulting firm in Australia and Asia, and has participated in a wide range of life insurance consulting assignments. From 2006 to 2010 Mr Trowbridge was one of three APRA Members where he had carriage of life and general insurance.

Association of Financial Advisers (AFA) Representatives

Mr Brad Fox, CEO AFA

Mr Brad Fox is currently the Chief Executive Officer of the Association of Financial Advisers. Previous to this role Mr Fox was a financial advice practice owner and adviser for 8 years and spent 5 years as an AFA Board Member including 2 years as the AFA President.

Mr John de Zwart, CEO Centerpoint Alliance

Mr John de Zwart is currently the Chief Executive Officer of Centrepoint Alliance, the largest non-institutionally controlled advice business in Australia. Mr de Zwart has has over 25 years of senior executive experience in the Australian, UK and NZ financial services industry including roles at TAL and AMP.

Mr Jeff Thurecht, Director and Financial Adviser at Evalesco Financial Services

Mr Jeff Thurecht is currently a Director and Financial Adviser at Evalesco Financial Services. Mr Thurecht is also a NSW State Director of the Association of Financial Advisers (AFA). Mr Thurecht has over 17 years in the industry, and has held previous roles within life insurance, management, paraplanning and financial advice.

Financial Services Council (FSC) Representatives

Ms Sally Loane, CEO Financial Services Council

Ms Sally Loane is currently Chief Executive Officer of the Financial Services Council. Previous to this role Ms Loane was a director of media and public affairs for top 50 ASX Listed company, Coca-Cola Amatil. Ms Loane was a broadcaster and journalist before entering the corporate sector.

Mr Geoff Summerhayes, CEO Suncorp Life

Mr Geoff Summerhayes is currently Chief Executive Officer Suncorp Life. Mr Summerhayes is also a director of the FSC and co-chair of the FSC's Life Board Committee. Mr Summerhayes has more than 20 years experience across property and financial services with previous roles at Lend Lease, MLC and NAB.

Mr Andrew Hagger , Group Executive NAB Wealth

Mr Andrew Hagger is currently Group Executive, NAB Wealth. Mr Hagger is also a director of the FSC and co-chair of the FSC's Advice Board Committee. Prior to joining NAB, Mr Hagger spent 21 years with PricewaterhouseCoopers (PwC) in a number of capacities, including Melbourne Managing Partner and as a member of PwC's Firmwide Leadership Team.

APPENDIX 2 – WARNING SIGNS AND LIFE INSURANCE ADVICE CHECKLIST

Table A1: ASIC's Warning signs of poor advice

Warning sign	Commentary
High clawback rates	High clawback rates per adviser may be a warning sign about the quality of the advice that the adviser is giving to their clients. Clawbacks can be a telling indicator that advisers are rewriting business to earn commission income and providing product replacement advice that is not in the best interests of their clients. AFS licensees should monitor clawback rates and policy lapses across their advisers.
High volumes of new business with 'no underwriting issues'	Advisers may write new business in online applications or under certain limits to avoid triggering any compliance concerns—to 'fly under the radar'. This may be a warning sign that the automatic underwriting process is being abused. Automatic underwriting means that advisers can ensure questions are answered in such a way so as not to raise any warning signs. This abuse of the automatic underwriting process can cause significant detriment to clients and expose AFS licensees to compensation claims from clients. Insurers should have robust systems in place to review new business and ensure that automatic underwriting is not being abused.
Poor or inadequate needs analysis	Failure by an adviser to ask the most rudimentary questions about the client's relevant circumstances may be a warning sign that the advice is not in the best interests of the client. Advisers who fail to perform and record an appropriate needs analysis of their clients present a significant risk to an AFS licensee's business. An appropriately detailed needs analysis is also important to ensuring that scaled advice is delivered appropriately. AFS licensees should actively review the quality of the needs analysis.
High volumes of replacement product advice, product bundling and upselling	AFS licensees should actively monitor files for advice to clients that recommends the client hold multiple policies where the recommendation suggests that the clients may be overinsured relative to their insurance needs and income. Where the business model is dependent on the incentives to advisers to write new business, AFS licensees should actively monitor representatives writing high volumes of new business, particularly replacement business written after the expiry of the clawback period on the previous policy.
Competency	File reviews should consider the following warning signs that the adviser is not competent to provide the advice: • inadequate inquiries into the client's relevant personal circumstances; • poor record keeping and inadequate documentation on the file to found a basis for the advice; and • poor consideration of related issues of strategic importance for clients, such as the need for clients to nominate beneficiaries (and update nominations) for death benefits in superannuation.
Insurance paid for using a high percentage of the client's superannuation guarantee contributions	Life insurance advice recommending a client pay insurance premiums using a significant percentage of their superannuation guarantee contribution may be a warning sign that the advice is not in the best interests of the client. AFS licensees should review files to ensure that the effect of this strategy is modelled to show the loss of retirement income over time and the extent to which the advice considers contribution strategies as appropriate to the client's circumstances.
Poor record keeping	Record keeping is essential to prove compliance with s961B(2) and to enable licensees to comply with their obligations to monitor and supervise their representatives. Poor record keeping should be a key warning sign to an AFS licensee that the advice may not be compliant.
Poor compliance with disclosure obligations and use of generic warnings	Generic warnings and non-specific information about strategy may be a warning sign that the advice may not be in the best interests of the client. AFS licensees should review files to ensure that the SOA includes relevant information about the basis on which the advice was given. This includes: • a clear and specific explanation to the client about the rationale for and implications of a recommended strategy; • the pros and cons of a strategy to pay for insurance inside or outside superannuation; and • consideration of the importance of the duty of disclosure where a client is given switching advice.

Extract A1: ASIC's 'The challenges for insurers and advisers'

- 250 There is no doubt that the findings in this report represent a significant challenge to the insurance industry, advisers, regulators and consumers.
- 251 Insurers should:
- (a) review their remuneration arrangements to ensure that consumer interests are prioritised and that conflicts of interest are better managed; and
 - (b) develop simpler products that may better balance affordability issues against insurance needs.
- 252 Advisers should:
- (a) review and amend, as appropriate, business models to address structural barriers to the provision of compliant life insurance advice; and
 - (b) when presented with a conflict of interest, act according to what a reasonable adviser without a conflict would do.
- 253 Advisers are in the business of giving personal advice in most situations. The value of personal advice is that it:
- (a) is tailored to the client and their relevant personal circumstances;
 - (b) considers the client's insurance needs and balances those needs against their other priorities;
 - (c) does not rely on generic calculations to reach a sum insured or fail to make inquiries of the client to test or challenge their assumptions; and
 - (d) leaves the client in a better position.
- 254 Observations drawn from our surveillance, recent case law and industry experience give us an opportunity to reflect on the value that life insurance advice should give to consumers.
- 255 Advisers can help consumers in making key strategic decisions such as setting, and as personal needs change, revising their sum insured. Such strategic advice can help the client balance the competing priorities of insurance needs against cost.
- 256 Unlike the direct market, consumers who retain the services of an adviser should have the benefit of the adviser's expertise and judgement.

- 257 Competent advisers know, or ought to know, the importance of exercising particular diligence when recommending a client switch their insurance product because of the remedies available to an insurer where the insured person fails to comply with their duty of disclosure.
- 258 Advisers can help clients ‘triage’ their insurance needs by prioritising the essential and the non-essential and explain the costs, benefits and value of different options to the client to help them make an informed decision as to their insurance needs and priorities.
- 259 Advisers can give essential assistance to clients when a claim is made, reducing the need for lawyers to advocate for their clients where a claim may be denied or only partially paid by the insurer.

Table A2: ASIC's Life insurance advice checklist

Issue	Considerations
What are the client's objectives?	Good life insurance advice should ensure a client's objectives are specific, measurable and prioritised: see RG 175.218(c). Objectives may include: • debt reduction/repayment; • emergency/cash funds; • medical expenses or home renovation expenses; • education or business-related expenses; and • a lump sum amount to produce a level of regular income for financial dependants for a period of time. Note: This is not an exhaustive list. Good advice should be able to identify further client objectives relevant to insurance, such as: • nominating a beneficiary on the policy; or • seeking legal advice on a will. Good advice should also use a client's objectives to define the scope of the advice.
What are the client's financial situation and needs?	Good advice is founded on a solid strategy that requires identification of the client's relevant personal and financial situation and needs. The adviser should identify, discuss and document the client's: • financial position (income, expenses, assets and liabilities); • personal circumstances (age, relationship status and family circumstances); • foreseen changes to their personal or financial position (inheritance, home renovations, divorce, new baby, sale of business); • existing insurance arrangements (including insurance held inside their superannuation fund); • health status (including any hereditary or genetic conditions that may affect their ability to obtain insurance); • insurance needs (life, disability, illness or income) and the relative priority of these needs; and • willingness and capacity to pay insurance premiums and over what time period. Good advice should explore with the client alternatives that may be available if the client wishes to self-insure in part or in whole, and an insured event arises. Such 'self-insurance strategies' may include: • the client's leave entitlements, employee benefits and liquid assets; • the client's ability to rely on extended family support or to downsize their home to access capital; • returning to work or increasing working hours; and • any entitlements the client has to social security and/or workers or transport accident compensation arrangements.

Issue	Considerations
Providing balanced scaled advice	When providing scaled advice, good advice will respond to the client's stated objectives and implicit needs. For example, a client may state they wish to obtain cheaper insurance and the adviser and client agree to scope the advice to this issue. Good advice should include further considerations relevant to obtaining life insurance, including: • the costs and benefits of holding existing levels of cover and the client's priorities regarding their insurance; • the coverage of any replacement insurance product; • how long the client wants to hold the insurance and of what type; • alternative options, including revising down the sum insured or modifying the selection of optional extras; and • the merits and hazards of switching policies as a strategy to manage affordability (such as s29(3) of the Insurance Contracts Act). Good advice should also consider: • giving clear and specific warnings to the client about the cost impact of their insurances relative to their income, debt, insurance needs or retirement goals; and • giving practical guidance to the client about self-insurance strategies (see the list above on self-insurance strategies).
Making a recommendation to retain a current insurance product	An adviser must: • conduct a reasonable investigation into the financial products that might achieve the client's objective and meet the client's needs that would reasonably be considered relevant to the subject matter of the advice (s961B(2)(e)(i)); and • assess the information gathered in the investigation (s961B(2)(e)(ii)). Good advice should consider the client's existing insurance arrangements and consider whether the best solution for the client may be to retain their existing insurer but modify the type or amount of cover. An adviser may consider: • the amount of leave the client may have, including sick leave, annual leave and long-service leave; and • any alternatives that may be available if the client wishes to employ self-insurance strategies (see the list above on self-insurance strategies). In some cases, it is unlikely that a product recommendation will be appropriate. For example, a client nearing retirement may have accrued long-service leave, more than a year of annual leave and be a member a defined benefit superannuation fund that will pay out a defined lifetime benefit if the client ceases work permanently (even before retirement age). To achieve such a client's objectives of having sufficient income if temporarily disabled, a product recommendation is unlikely to be appropriate.
Making a recommendation to replace an insurance product	Replacement product advice must be appropriate to the client. Good replacement product advice should carefully consider important risks to the insured in switching policies. This is particularly important where an adviser recommends a switch to a cheaper premium because such a strategy can have significant risks for a client. In addition to documenting the client's objectives, financial situation and needs, good replacement product advice should: • consider and address affordability issues in the strategy for achieving the client's objectives. This may include self-insurance strategies (see the list above on self-insurance strategies); • carefully consider how long the client wants to hold insurance, along with careful consideration of the client's current and any foreseeable future health challenges; • clearly describe the long-term impact of a recommendation to pay the premium from the

Issue	Considerations
	client's superannuation benefits and consider options to ameliorate the impact on future retirement income as appropriate to that client's personal circumstances; and - carefully consider the operation of s29(3) of the Insurance Contracts Act. This provision represents a significant risk to consumers where product replacement advice is given because it allows an insurer to avoid a contract of insurance within three years of commencement where the client failed to comply with the duty of disclosure. The operation of this provision is particularly important for a client who has held an existing policy for more than three years and for whom the insurance represents a significant asset. Poor replacement product advice may risk the client losing the important protection of an existing insurance policy. Courts have recently held advisers liable for compensation to clients for misleading and deceptive conduct, and negligence, when switching clients from one insurance policy to another. The advice should clearly explain - why the new product is better than the old product; - what specific features are better and what has been lost. Where the rationale is 'better policy terms', those improved policy terms should be spelled out; - where software has been used to rate policies, advisers should spell out why a particular product has a higher rating, and what features will be lost in a switch; and - where new policies have waiting periods, such as trauma policies, advisers should exercise due care and diligence to ensure that extant policies are not cancelled while waiting periods are in force (e.g. where a client is managing a current illness or awaiting a diagnosis).
Making a recommendation to pay for insurance from superannuation	Good advice that recommends a client pay insurance premiums from their superannuation contributions cannot ignore the advantages and disadvantages of this strategy. Specifically, advisers should ensure their client understands that: - the insurance policy is owned by the trustee of the superannuation fund on behalf of the member; - the <i>Income Tax Assessment Act 1997</i> dictates how the proceeds are taxed, which differs from personally held insurance policies. If the client meets the SIS Act permanent incapacity definition and the trustee pays their superannuation (including total and permanent disability insurance) balance out, the tax payable depends on a range of factors, including age and the existing tax-free component of their superannuation; and - superannuation is not a personally held asset and generally is not dealt with by a person's will or estate planning. Clients must ensure their nomination of beneficiaries reflects their wishes and they must decide whether they need a binding or non-binding nomination of beneficiaries. If there is no nomination of beneficiary, the superannuation fund trustee will use their discretion on how to pay death benefits. Generic warnings to clients that paying for insurance from superannuation has cash flow benefits but will erode retirement savings are not adequate. Advisers should address the key risk of funding insurance premiums from superannuation funds, that is, that it may prevent the client from meeting their retirement objectives. Advisers should give adequate consideration to this risk when recommending this strategy. This should include consideration about making concessional or non-concessional contributions that at least negate the effect of insurance premiums on retirement benefits. If this option is not appropriate for the client's circumstances, the risks of the strategy need to be clearly explained to the client, including communicating the cost impact. Advice recommending a contribution strategy should also consider the impact on the client's cash flow. This may include comparing the value of making concessional and non-concessional contributions equivalent to the insurance premiums. We expect advisers to: - communicate that the cost impact of insurance is simply being deferred from today's cash

Issue	Considerations
Statement of Advice	flow to future cash flow and that the client needs to actively consider the long-term impact of this and strategies to manage it; - inform and model for their client the impact on their retirement savings balance with and without insurance premiums over their retirement horizon (e.g. if the client is 20 years from retirement); - communicate that every dollar spent on the insurance premium is a dollar less invested for retirement, and this impact compounds over time where the client may otherwise have a long investment horizon; and - cover the fact that the client may need to work longer to save for retirement. The SOA must clearly set out the basis on which the advice was given: see RG 175.159–RG 175.196. Good advice should clearly document in the SOA the strategy for achieving the client's objectives, including the product features and client circumstances relevant to the subject matter. Regardless of whether advice is comprehensive or scaled narrowly, an adviser who is acting in the client's best interests should actively engage with their client to gather sufficient information, and apply their knowledge and experience, to provide personal insurance recommendations. Where the client instructions may be <i>'I want to keep the same insurance cover, but I want a cheaper premium'</i>, the adviser should discuss why the client is seeking personal advice and explore the cash flow issues that inform that client instruction, as well as whether personal advice is appropriate in this situation. If the client wants personal advice, the SOA should document how the recommended amounts of insurance were arrived at, by reference to the client's circumstances. When a replacement product is recommended (in full or in part), the SOA must include information about: - the cost of the recommended action (i.e. the disposal of the existing product and acquisition of the replacement product); - the potential benefits (pecuniary or otherwise) that may be lost; and - any other significant consequences of the switch for the client.
Personal or general advice	Good advice should clearly communicate to the client whether the adviser has considered their relevant personal circumstances in formulating the advice.

BIBLIOGRAPHY

APRA Website 'Life Insurance & Friendly Societies'
<<http://www.apra.gov.au/lifs/Pages/default.aspx>>

APRA Website 'Protecting Australia's depositors, insurance policyholders and superannuation fund members' <<http://www.apra.gov.au/AboutAPRA/Publications/Pages/APRA-Brochure.aspx>>

APRA (2013) *Insight Issue Three 2013*, 'General Insurance industry overview'
<<http://www.apra.gov.au/Insight/Pages/Insight-Issue-Three-2013-HTML.aspx>>

ASIC (2014) *ASIC Annual Report 2013-2014*

ASIC Consultation Paper 183

ASIC Regulatory Guide 90

ASIC Regulatory Guide 175

ASIC Regulatory Guide 200

ASIC Regulatory Guide 246

ASIC Report 413 (2014) 'Review of retail life insurance advice'

ASIC Report 224 (2010) 'Access to financial advice in Australia'

Corporations Act 2001 (Cth)

Financial Services Council (2014) *Financial System Inquiry Submission 2*

Fullagar, Col, 'Risk insurance premiums stepping up to the plate' *Money Management*, 18 February 2011 <<http://www.moneymanagement.com.au/news/insurance/archive/risk-insurance-premiums-stepping-up-to-the-plate>>

Keenan, Bruce. (2014) 'Why it's time to standardise statements of advice', *Money Management*, <<http://www.moneymanagement.com.au/opinion/news-in-focus/why-it-s-time-to-standardise-statements-of-advice>>

Keneley, M. (2003), 'Adaptation and Change in the Australian Life Insurance Industry: A Historical Perspective', *Accounting History Review*, v14(1), pages 91-109
<http://ideas.repec.org/p/dkn/econwp/eco_2003_08.html>

KPMG (2014) *Underinsurance Disability Protection Gap in Australia*

Liberal Party of Australia Website <<http://www.liberal.org.au/latest-news/2011/05/27/shorten-must-clarify-commissions-ban-0>>

Parliament of Australia, 'Bills Digest no 11, 2014-2014 - Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014' <
http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1415a/15bd011>

Parliamentary Joint Committee on Corporations and Financial Services 'Dissenting Report by Coalition members of the Committee'

<http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2010-13/future_fin_advice/report/d01>

Pokrajac, Milana, 'The new face of financial planning dealer groups', *Money Management*, 26 July 2012 <<http://www.moneymanagement.com.au/analysis/top-100-dealer-groups/the-top-100-financial-planning-dealer-groups-2012>>

Rice Warner 2015 (forthcoming), 'Risk Insurance Market Projections Report 2014'

Taylor, Mike 'Bipartisan support for Ripoll recommendations' *Money Management*, 23 November 2009 <<http://www.moneymanagement.com.au/news/financial-services/archive/bipartisan-support-for-ripoll-recommendations>>

The Treasury (2014) 'Details-stage Regulation Impact Statement - *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014* (Cth)'